Petition

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ALEXANDER L. STEVAS,
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No. 81-468

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1981

STATE OF MISSOURI, ex rel. MISSOURI PUBLIC SERVICE COMPANY,

Petitioner,

vs.

CHARLES J. FRAAS, Chairman, Commissioners, HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK McCARTNEY, and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

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QUESTIONS PRESENTED

Does the Due Process Clause of the Fourteenth Amendment to the United States Constitution guarantee to Petitioner the right to judicial review of an order of the Missouri Public Service Commission (the right to judicial review being provided by the Constitution of the State of Missouri, Article V, Section 18, and the Public Service Commission Law, Sections 386.510 and 386.540, R.S.Mo. 1978), with respect to an important and recurring legal issue (whether an attrition allowance is permissible in a public utility ratemaking proceeding), for guidance of the Commission and utilities in future cases which are certain to involve the same issue, although the rates approved in the instant case cannot be revised retroactively and have been superseded by rates approved in subsequent cases?

Does the guarantee of Due Process of Law under the Fourteenth Amendment to the Constitution of the United States extend the princi-

ple declared in Southern Pacific Terminal Company v. Interstate Commerce Commission, 219 U.S. 498 (1911), (i.e., the right to judicial review of legal issues involved in superseded short-term orders of federal administrative agencies when such legal issues are recurring and otherwise likely to evade judicial review) to a party affected by a similar short-term order of a state administrative agency?

Has Petitioner been denied Due Process of Law under the Fourteenth Amendment to the United States Constitution where the initial state reviewing court determined that the Missouri Public Service Commission had erred and thereby deprived Petitioner of Due Process of Law by failing to make findings of fact and conclusions of law required by the Missouri Administrative Procedure Act regarding the important and recurring attrition allowance issue in this rate case, but the appellate reviewing court dismissed the Commission's

appeal for mootness simply because the rates subject to review had been superseded by new rates, thereby denying to Petitioner findings and conclusions on the attrition allowance issue and judicial review thereof?

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II. The Missouri Court of Appeal Dismissal of the Appeals for Mootness (on the ground that the rate order under review had been superseded by later orders) Deprived Petitioner of its Right to Judicial Review of the Attrition Allowance Issue, as Guaranteed by the Missouri Constitution, Article V, Section 18, and the Missouri Public Service Commission Law, Sections 386.510 and 386.540, R.S.Mo. 1978, and thereby Deprived

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CHARLES J. FRAAS, Chairman, Commissioners HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK McCARTNEY, and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,

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OPINIONS BELOW

The opinion of the Missouri Court of Appeals, Western District, is reported at 615 S.W.2d 587, and is reproduced as Appendix A, pp. 1-9.

The opinion of the Circuit Court of Cole County, Missouri, is reproduced as Appendix D, pp. 11- 28.

The Report and Order of the Public Service Commission of the State of Missouri is reproduced as Appendix E, pp. 29-89.

JURISDICTION

The judgment of the Missouri Court of Appeals, Western District, was entered on March 30, 1981, and a copy thereof is appended to this petition as Appendix A, pp. 1-9. Petitioner filed timely motions for rehearing and for transfer to the Supreme Court of Missouri, both of which motions were denied by order of the Missouri Court of Appeals, Western District, on May 4, 1981; a copy

of such order is appended to this petition as Appendix B, p. 9. Petitioner then filed a timely application for transfer to the Supreme Court of Missouri, which application was denied by order of the Supreme Court of Missouri on June 8, 1981; a copy of such order is appended to this petition as Appendix C, pp. 9-11. The jurisdiction of this court is invoked under 28 U.S.C. 1257(3).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The federal constitutional provision involved is Amendment XIV, Section 1, Constitution of the United States, which provides in relevant part:

> . . . nor shall any state deprive any person of . . . property without due process of law . . ..

The state constitutional provision involved is Article V, Section 18, Constitution of the State of Missouri, which provides in relevant part:

> Section 18. Judicial review of

> action of administrative agencies--scope of review. All final decisions, findings, rules and orders of any administrative officer or body existing under the constitution or by law, which are judicial or quasi-judicial and affect private rights, shall be subject to direct review by the courts as provided by law; and such review shall include the determination whether the same are authorized by law, and in cases in which a hearing is required by law, whether the same are supported by competent and substantial evidence upon the whole record. . . .

The state statutes involved are:

1. Section 386.510, Missouri Revised Statutes, 1978, which provides in relevant part:

> 386.510. Review by circuit court.--. . . the applicant may apply to the circuit court of the county where the hearing was held or in which the commission has its principal office for a writ of certiorari or review (herein referred to as a writ of review) for the purpose of having the reasonableness or lawfulness of the original order or decision or the order or decision on rehearing inquired into or determined. . . . No new or additional evidence may be introduced upon the hearing in the circuit court but the cause shall be heard by the court without the intervention of a jury on the evidence and exhibits introduced before the commission and certified to by it. . . . Upon the hearing the circuit court shall

> enter judgment either affirming or setting aside the order of the commission under review. . . . The court may, in its discretion, remand any cause which is reversed by it to the commission for further action. . . . The circuit courts of this state shall always be deemed open for the trial of suits brought to review the orders and decisions of the commission as provided in the public service commission law and the same shall be tried and determined as suits in equity.

2. Section 386.540, Missouri Revised Statutes, 1978, which provides in relevant part:

> 386.540. Appeals from circuit court--Transcript and exhibits--precedence over other civil cases.--1. The commission and any party, including the public counsel, who has participated in the commission proceeding which produced the order or decision may, after the entry of judgment in the circuit court in any action in review, prosecute an appeal to a court having appellate jurisdiction in this state. Such appeal shall be prosecuted as appeals from judgment of the circuit court in civil cases except as otherwise provided in this chapter. . . .

3. Section 536.090, Missouri Revised Statutes, 1978, which provides in relevant part:

> 536.090. Decisions in writing--

> notice.--Every decision and order in a contested case shall be in writing, and, . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order. . . .

STATEMENT OF THE CASE

On August 4, 1977, the Petitioner, Missouri Public Service Company, filed tariffs with the Missouri Public Service Commission specifying increases in gas and electric rates. The Commission ordered the rates suspended pending hearings.

Public hearings were held by the Commission in April, 1978, during which both the Commission's Staff and Petitioner offered uncontroverted evidence that attrition had occurred with respect to the previous rates of return authorized by the Commission for the Petitioner (Transcript [T] 388-89; Petitioner's Exhibit 1, Section 7, Schedule 2; T 496-97; Staff Exhibit 2, Schedules 21, 22). Staff

witness Burkhardt testified that the following five principal factors contribute to attrition: (1) declines in kilowatt-hour sales growth; (2) new plant additions; (3) inflation; (4) increase in fixed capital costs; and (5) operational difficulties with generating plant (T 497-498). Of these five factors, the witness indicated that declines in kilowatt-hour sales growth is the most significant determinant of attrition for many electric companies (T 498). He saw no indication that these factors would not continue in the future (T 498-499). The Staff witness stated that his model for determining the rate of return only considered the additional cost related to new fixed charges on capital (T 499). Consequently, his model would not account for attrition resulting from the other four factors. Both Staff and Petitioner's witnesses recommended an attrition allowance (T 387-389; Petitioner's Exhibit 1, Section 7, Schedule 6; T 499). Staff's witness recommended that the

Commission specifically set forth the approved attrition allowance if, during the past years, as both Petitioner's and Staff's exhibits demonstrated, Petitioner had been unable to earn the return authorized by the Commission (T 499). Petitioner's witness testified that over the past five years Petitioner had suffered on the average a 20 percent shortfall of the authorized return because of attrition (T 388; Petitioner's Exhibit 1, Section 7, Schedule 2). Consequently, he conservatively recommended that an attrition allowance of .28 percent be added to the rate of return on original cost net rate base (T 387-389; Petitioner's Exhibit 1, Section 7, Schedule 6).

Following the hearings, the Commission issued its report and order on June 23, 1978, to become effective July 5, 1978, which denied in great part Petitioner's request to increase its rates. The Commission's report and order is appended to this petition as Appendix E, pp. 29-89.

The Commission's report and order contained neither findings of fact nor conclusions of law with respect to the Petitioner's request for an attrition allowance, or the uncontroverted evidence of both the Commission's Staff and the Petitioner establishing that attrition had occurred and the evidence of the Petitioner quantifying the amount and effect thereof. The Commission's report and order did not mention attrition.

On July 3, 1978, Petitioner filed an Application for Rehearing before the Commission, in which the Petitioner alleged that the Commission's failure to make any findings of fact or conclusions of law on the attrition allowance issue deprived Petitioner of Due Process of Law in violation of Article XIV, Amendments to the United States Constitution (Application for Rehearing, pp. 1, 2, 5 and 6). On July 12, 1978, the Commission entered its order denying Petitioner's Application for Rehearing (Appendix F, pp. 90-91). The

Commission's order made no mention of the attrition allowance issue, or of the absence of any findings of fact or conclusions of law with respect to the attrition allowance issue in the Commission's earlier report and order, or of the aforementioned federal constitutional issue raised in Petitioner's Application for Rehearing.

Petitioner timely filed a petition for writ of review of the order of the Commission in the Circuit Court of Cole County, Missouri, in which Petitioner incorporated by reference as grounds for review the points specified in Petitioner's aforementioned Application for Rehearing filed with the Commission, including deprivation of Due Process of Law under Article XIV, Amendments to the United States Constitution (Petition for Writ of Review, paragraph 8). While the petition for writ of review was pending in the Circuit Court of Cole County, Petitioner was granted gas and electric rate increases in cases filed with

the Commission subsequent to the rate cases involved herein, and, on that basis, the Commission moved to dismiss the review proceeding in the Circuit Court contending that the review proceeding was moot.

On December 19, 1979, the Circuit Court of Cole County, Missouri, entered its findings, conclusions and judgment denying the Commission's motion to dismiss and reversing and remanding the order of the Commission for, inter alia, the Commissions's failure to make findings and conclusions on the attrition allowance issue (Appendix D, 11-28).

With respect to the Commission's failure to make findings of fact and conclusions of law on the attrition allowance issue, the Circuit Court found as a fact:

> Moreover, and more flagrant, it is impossible to determine whether an attrition allowance was included or excluded. Such an allowance is calculated to offset inflationary factors leading to a failure to earn an allowed rate of return and, in effect, confiscation of relator's property. The evidence respecting

> the need for and appropriateness of an attrition allowance was undisputed by both company witnesses and the responsible staff witness. This evidence discloses that the economic environment has prevented relator from earning the authorized return for a number of years and that these same environmental factors will persist in the future. To deny relator an attrition allowance under the record in this case insures a denial of an opportunity to earn a reasonable rate of return upon invested capital. This is confiscation. (Findings of Fact, paragraph 2, Appendix D, pp. 15-16).

The Circuit Court made the following pertinent conclusions of law:

3.

> The purported findings and conclusions in the Report and Order are insufficient in that they fail to decide live, contested and controlling issues and fail to disclose how live, contested and controlling issues were decided. Section 563.090 [536.090], V.A.M.S.; State ex rel. St. Louis Public Service Company v. Public Service Commission, 291 SW 2d 95, 98 (Mo. 1956); Iron County v. State Tax Commission, 480 SW 2d 65 (Mo. 1972); Stephen v. State Tax Commission, 499 SW 2d 798 (Mo. 1973); St. Louis County v. State Tax Commission, 515 SW 2d 446 (Mo. 1974); Century State Bank v. State Banking Board, 523 SW 2d 856 (Mo. App. 1975).

4.

Insufficient findings and conclusions and lack of findings and conclusions in the Report and Order of respondent deprive relator of due process under the provisions of Article V and Article XIV, Amendments to the United States Constitution, and Article I, §§10 and 26, Constitution of Missouri.

5.

Erroneous findings and conclusions, insufficient findings and conclusions, and lack of findings and conclusions in the Report and Order of respondent result in the confiscation of relator's property and take relator's property for public use without just compensation in violation of Article V and Article XIV, Amendments to the United States Constitution, and Article I, §26, Constitution of Missouri. Federal Power Commission v. Hope Natural Gas Company, 320 US 590 (1944); Bluefield Waterworks and Improvement Company v. West Virginia Public Service Commission, 262 US 679 (1923); Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission, 262 US 276 (1923); United Railway and Electric Company v. West, 280 US 234 (1930); State ex rel. Missouri Water Company v. Missouri Public Service Commission, 308 SW 2d 704 (Mo. 1957). (Appendix D, pp. 26-28)

The Circuit Court also denied the Commission's motion to dismiss for mootness, as follows:

> The motion is not well taken. The Court finds that, while such increases in electric and gas rates have been authorized and implemented since the instant appeal, a finding of mootness now would effectively deny relator judicial review, particularly when regulatory lag and the time required for judicial review are considered, together with recent and current economic conditions which mandate successive rate cases with little time intervening. Moreover, the instant appeal presents important legal issues of public significance which are likely to recur and which could not otherwise be reached upon appeal and review if the mootness doctrine is invoked. Gas Service Company v. Public Service Commission, 536 SW 2d 491, 493 (Mo. App. 1976); Laclede Gas Company v. Public Service Commission, 535 SW 2d 561, 565 (Mo. App. 1976). The issues here need to be considered, determined and, hopefully, set at rest, State ex rel. Utility Consumers Council, etc., v. Public Service Commission, 585 SW 2d 41 (Mo. banc 1979); Reser v. Rush, 562 SW 2d 365 (Mo. banc 1978). (Appendix D, pp. 12-13)

Both the Commission and Petitioner filed timely appeals from the judgment of the Circuit Court to the Missouri Court of Appeals, Western District. Only the appeal by the Commission of the Circuit Court's reversal and remand, however, is involved in the present

petition for writ of certiorari. In its brief, the Commission urged that both appeals be dismissed because the Petitioner had been granted two rate increases since the Commission's report and order in this case. In its Respondent's Brief in Response to the Commission's Appeal, Petitioner preserved its federal constitutional claims with respect to the attrition allowance issue (Respondent's Brief, pp. 35-40, 42-43, 44-46, 50-54 and 81-87) and argued, in opposition to the Commission's contention that both appeals should be dismissed for mootness, that to do so would deprive Petitioner of Due Process of Law under the Fourteenth Amendment to the United States Constitution, because the issues upon which the Circuit Court of Cole County had reversed and remanded the order of the Commission -- including, in particular, the apparent failure of the Commission to permit an attrition allowance and the failure of the Commission to make findings of fact and conclusions of

law with respect to an attrition allowance -- were recurring issues of substantial public interest with respect to which Petitioner was entitled to judicial review for the future guidance of the Commission and which otherwise would evade judicial review (Respondent's Brief, pp. 21-34). The Court of Appeals, however, dismissed both appeals, holding that:

> This case presents only factual issues with no issue of public importance which requires determination when this case has become moot. State ex rel. Gas Service v. Public Service Commission, 536 S.W.2d 491, 493 (Mo. App. 1976). Because MPS has been granted two rate increases since the report and order in question here, this case is now moot, and the appeal [sic] is dismissed. Missouri Public Service Company v. Pierce, 604 S.W.2d 623 (Mo.App. 1980). (Appendix A, pp. 8-9; 615 S.W.2d 587, 589).

With respect to the attrition allowance issue, the Court of Appeals said:

> "Attrition allowance" is discussed in State ex rel. Kansas City Power & Light Company v. Public Service Commission of Missouri, 615 S.W.2d 596 (Mo.App. 1981) [No. WD 31,821 adopted concurrently herewith] and there determined that this is not

> a unique principle which requires adjudication. (Appendix A, p. 8; 615 S.W.2d 587, 589.)

The Court of Appeals' opinion contained no discussion of the Commission's failure in this case to make any findings of fact or conclusions of law with respect to the uncontroverted evidence of the fact and quantifiable effect of attrition, whereas in the Kansas City Power & Light decision the Court of Appeals had held, on the record presented there: "The extent of adjustment [of the test period] for known variations [attrition] is essentially a factual question." (615 S.W.2d 596, 597). Failure of the Commission to make findings of fact and conclusions of law with respect to an attrition allowance issue was not involved in the Kansas City Power & Light Company appeal; the only question presented there with respect to an attrition allowance issue was whether the Commission's order was supported by competent and substantial evidence.

Petitioner timely filed in the Missouri Court of Appeals, Western District, motions for rehearing and for transfer to the Supreme Court, in which Petitioner preserved its federal constitutional claims with respect to the attrition allowance issue and argued that the dismissal of the judicial review proceedings for mootness deprived Petitioner of Due Process of Law, under the Fourteenth Amendment to the United States Constitution, because the issues upon which the Circuit Court of Cole County had reversed and remanded the order of the Commission (including, in particular, the failure of the Commission to permit an attrition allowance and the failure of the Commission to make findings of fact and conclusions of law with respect to the attrition allowance) were recurring issues of substantial public interest with respect to which Petitioner was entitled to judicial review for the future guidance of the Commission, and which otherwise would evade judicial

review (Motion for Rehearing paragraphs 1-5; Motion for Transfer, paragraphs 1-5). On May 4, 1981, the Court of Appeals denied Petitioner's Motions for Rehearing and Transfer without specifically ruling upon Petitioner's federal constitutional claims (Appendix B, p. 9). Petitioner then timely filed its Application in the Supreme Court of Missouri for Transfer of the appeals to the Supreme Court of Missouri, in which Petitioner again preserved the aforementioned federal constitutional issues (Application for Transfer, paragraphs 5-10). On June 8, 1981, the Supreme Court of Missouri entered its order and judgment denying Petitioner's Application for Transfer without specifically ruling upon Petitioner's federal constitutional issues (Appendix C, pp. 9-11).

REASONS FOR GRANTING THE WRIT

The ultimate question presented in this petition can be summarized as: Is the exception to the mootness doctrine declared in Southern Pacific Terminal Company v. Interstate Commerce Commission, 219 U.S. 498, 31 S.Ct. 279 (1911), affording judicial review of recurring legal principles involved in already superseded short-term orders of administrative agencies, which otherwise would evade judicial review, applicable to the states through the Fourteenth Amendment to the United States Constitution?

This is an important question of federal law which has not been, but should be, settled by this Court.

In terms of the instant case, the question is: Has Petitioner been denied Due Process of Law under the Fourteenth Amendment where the initial state reviewing court determined that the Missouri Public Service Commission erred and thereby deprived Petitioner of

Due Process of Law by failing to make findings of fact and conclusions of law required by the Missouri Administrative Procedure Act regarding the important and recurring attrition allowance issue, but the appellate reviewing court dismissed the Commission's appeal for mootness simply because the rates subject to review had been superseded by new rates, thereby denying to Petitioner findings and conclusions regarding the attrition allowance issue and judicial review thereof?

The Petitioner raised the question of whether the Due Process clause of the Fourteenth Amendment to the United States Constitution guaranteed to Petitioner the right to judicial review of the recurring legal issue of the attrition allowance in its Respondent's brief in the Court of Appeals, and preserved the issue in its motions for rehearing and transfer to the Supreme Court of Missouri, filed in the Court of Appeals, and also in its subsequent application for transfer to the

Supreme Court filed in the Supreme Court of Missouri. The Court of Appeals ignored the constitutional issue; evaded the legal issue of the right to consideration of an attrition allowance (on a record containing uncontroverted, substantial and competent evidence of both the fact of attrition and the quantifiable effect thereof) by asserting that the case presented "only factual issues with no issue of public importance," Appendix A, p. 8; and dismissed the appeals as moot, even though the order of the Commission had been reversed by the initial reviewing court for the Commission's failure to make any findings of fact or conclusions of law with respect to the attrition allowance issue, Appendix D, pp. 15-16, 26-28. The Court of Appeals then ignored the federal constitutional issues in denying Petitioner's Motions for Rehearing and for Transfer to the Missouri Supreme Court, Appendix B, p. 9. The Missouri Supreme Court also ignored the federal constitutional issues

in denying Petitioner's application for transfer to the Supreme Court, Appendix C, p. 10.

I. The Commission's Failure to Make Findings of Fact and Conclusions of Law with Respect to the Attrition Allowance Issue Violated the Missouri Administrative Procedure Act, Section 536.090, R.S.Mo. 1978, and Deprived Petitioner of its Property without Due Process of Law, in Violation of the Fourteenth Amendment to the United States Constitution.

That there was substantial, uncontroverted and competent evidence introduced by both the Commission's Staff and the Petitioner of the fact that attrition in Petitioner's anticipated rate of return had occurred in the past and was likely to occur in the future, and that there was substantial, uncontroverted and competent evidence introduced by the Petitioner quantifying the amount and effect of such attrition has never been in dispute in this case.

Nor can there be any dispute that in the process of deciding these rate cases and

entering its order, the Commission failed to make any findings of fact or conclusions of law regarding the attrition allowance issue. The Commission not only failed to undertake any articulated consideration of the attrition allowance issue, it did not even mention the issue.

Accordingly, the initial reviewing court, the Circuit Court of Cole County, Missouri, found (Appendix D, pp. 12-13):

> Moreover, and more flagrant, it is impossible to determine whether an attrition allowance was included or excluded. Such an allowance is calculated to offset inflationary factors leading to a failure to earn an allowed rate of return and, in effect, confiscation of relator's property. The evidence respecting the need for and appropriateness of an attrition allowance was undisputed by both company witnesses and the responsible staff witness. This evidence discloses that the economic environment has prevented relator from earning the authorized return for a number of years and that these same environmental factors will persist in the future. To deny relator an attrition allowance under the record in this case insures a denial of an opportunity to earn a reasonable rate of return upon invested capital. This is confiscation.

The Circuit Court concluded, as matter of law (Appendix D, pp. 27-28):

4.

> Insufficient findings and conclusions and lack of findings and conclusions in the Report and Order of respondent deprive relator of due process under the provisions of Article V and Article XIV, Amendments to the United States Constitution, and Article I, §§10 and 26, Constitution of Missouri.

5.

> Erroneous findings and conclusions, insufficient findings and conclusions, and lack of findings and conclusions in the Report and Order of respondent result in the confiscation of relator's property and take relator's property for public use without just compensation in violation of Article V and Article XIV, Amendments to the United States Constitution, and Article I, §26, Constitution of Missouri. Federal Power Commission v. Hope Natural Gas Company, 320 US 590 (1944); Bluefield Waterworks and Improvement Company v. West Virginia Public Service Commission, 262 US 679 (1923); Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission, 262 US 276 (1923); United Railway and Electric Company v. West, 280 US 234 (1930); State ex rel. Missouri Water Company v. Missouri Public Service Commission, 308 SW 2d 704 (Mo. 1957).

Nor is there any serious question but

that when there is substantial, competent evidence supporting an element in a ratemaking case, the Missouri Administrative Procedure Act, Section 536.090, R.S.Mo. 1978, requires that the Commission make specific findings of fact and conclusions of law regarding that element.

Section 536.090, R.S.Mo. 1978, provides, in part:

> Every decision and order in a contested case . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order. . . .

The requirements of Section 536.090 apply to orders and decisions of the Public Service Commission. State ex rel. St. Louis Public Service Co. v. Public Service Commission, 291 S.W.2d 95, 98 (Mo. 1956) (en banc). In Iron County vs. State Tax Commission, 480 S.W.2d 65 (Mo. 1972), the Supreme Court of Missouri held that the findings of fact must

demonstrate how factual disputes were resolved, thus providing an explanation for the basis upon which the agency reached its conclusion. The Court noted that, 408 S.W.2d at 70:

> . . . the purpose in requiring such to be done is in order that the Circuit Court can know the basis for the agency's decision in order that it, the Circuit Court, can perform its limited review function and not substitute its discretion for that of the administrative agency.

Interpreting Section 536.090 in Stephen & Stephen Properties, Inc. vs. State Tax Commission, 499 S.W.2d 798 (Mo. 1973), the Supreme Court held that, because it was bound by the agency's findings if the same were supported by competent and substantial evidence, it could not infer findings from the ultimate decision of the agency because such an inference would defeat the limited scope of review in that it would allow the Court to review both the law and the facts on appeal. The Court outlined the five practical reasons

for the findings requirement, 499 S.W.2d at 804-05:

> These justifications include: (1) the facilitation of judicial review; (2) preventing judicial usurpation of administrative functions; (3) to protect against careless or arbitrary action (the requirement of findings, evokes "care on the part of the trial judge in ascertaining the facts." . . .); (4) to help parties plan their cases for rehearing and for judicial review; and (5) to keep the agencies within their jurisdiction. (citations omitted)

In St. Louis County vs. State Tax Commission, 515 S.W.2d 446 (Mo. 1974), the Court considered the sufficiency of findings and conclusions of the State Tax Commission with respect to a tax assessment. The parties differed sharply with respect to the appropriate method of evaluation and with respect to the appropriate factors to be used in a particular evaluation method. The Commission's ultimate finding of fact was simply that:

> With due deference to the testimony of both parties, the Commission finds the assessed value of the property to be $759,420, as of January 1, 1972. (515 S.W.2d at 450.)

The Court held that such a conclusory finding by the Commission failed to resolve the factual issues raised by the parties, was vague and uncertain, and provided no record from which the Court could determine the basis of the Commission's assessment finding. The Court noted that it was possible that the Commission had taken the figures proffered by the opposing parties, split the difference and then divided by three to reach the one-third assessed valuation. Although that figure, either by design or coincidence, equaled the valuation assessed by the Commission, the Court found the same to be arbitrary and insufficient. Summarizing the shortcomings of the findings, the Court stated, 515 S.W.2d at 451:

> They fail to resolve contested issues of fact; fail to find pertinent uncontroverted facts; fail to demonstrate the basis of the commission's ultimate decision; fail to state what factors the commission considered relevant to a determination of value and fail to indicate the effect of the chosen factors on the value of the property.

In Glasnapp vs. State Banking Board, 545 S.W.2d 382 (Mo.App. 1976), the Court of Appeals which decided the case at bar said, 545 S.W.2d at 387:

> The most reasonable and practical standard is to require that findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence.

The Commission is to determine just and reasonable rates of return upon the property of the gas or electric utility company which is used and useful in the public service. State ex rel. Martigney Creek Sewer Co. v. Public Service Commission, 537 S.W.2d 388 (Mo. 1976) (en banc). This requires determination by the Commission with respect to cost of money/rate of return, State ex rel. Hotel Continental vs. Burton, 334 S.W.2d 75 (Mo. 1960). An insufficient or inadequate finding on any given issue would preclude a

reviewing court from determining whether the decision was supported by substantial and competent evidence. Consequently, such a defective finding would not meet the requirements for adequate findings imposed by Section 536.090, R.S.Mo. 1978.

The Commission's findings of fact with respect to the issue of cost of money/rate of return, and particularly the subsidiary attrition allowance issue, plainly failed to meet those requirements. The portion of the Commission's report and order dealing with the issue consisted of five paragraphs of ultimate conclusions (Appendix E, pp. 35- 38). In this cavalier fashion, the report and order disposed of serious and substantial issues involving hundreds of pages of testimony and dozens of exhibits. It wholly ignored the attrition allowance issue.

The Commission arbitrarily picked a 12.70 percent rate of return on common equity as the "appropriate [rate of return on common equity]

to achieve that market price". The Commission utterly failed to articulate how it chose that return, or whether it included an allowance for attrition in settling upon the 12.70 percent rate.

Nowhere in the report and order is the source of the 12.70 percent approved return on equity disclosed. Significantly, the approved rate of return lies, by chance or design, near the midpoint (12.71%) of the Staff's recommended return, excluding any allowance for attrition.

This portion of the Commission's findings was very similar to that in St. Louis County vs. State Tax Commission, 515 S.W.2d 446 (Mo. 1974). As previously stated, in St. Louis County, the Supreme Court held that the finding with respect to the numerical value for the tax assessment valuation was improper and insufficient for it failed to resolve the issues of fact raised by the parties and failed to demonstrate the basis of the

ultimate decision in arriving at the assessed valuation. St. Louis County, 515 S.W.2d at 451. Such is the case at bar. The Petitioner's direct witness used a method for determining the return on equity which was quite different from that used by the Staff's witness. The return derived from these two approaches was significantly different. However, the Commission wholly failed to state whether it approved either the Petitioner's or the Staff's procedure. In fact, the findings of the Commission make it just as likely that the Commission utilized neither method, and simply arbitrarily allowed a rate of return at about the midpoint of the Staff's high and low recommendations.

It is impossible to determine from the findings and conclusions whether the Commission's approved rate of return made any allowance for the important element of attrition. An attrition factor is an allowance calculated to offset inflationary factors

which create a shortfall in any allowed rate of return (T 497). Both Petitioner witness Baker and Staff witness Burkhardt recommended an attrition allowance (T 387-390, 499).

Petitioner's witness Baker added an attrition adjustment of .28 percent to the rate of return on original cost net rate base (T 387-390). This adjustment was based upon an analysis of the erosion in common equity return actually earned compared with that found reasonable and authorized by the Commission. The amount was determined by comparisons of authorized returns with returns actually earned as portrayed in Petitioner's Exhibit 1, Section 7, Schedule 2 (T 388). During the previous five years, the Petitioner averaged earnings of only 80 percent of the amount authorized and the witness recommended an attrition allowance which was only one-third of the attrition actually experienced as a minimum for Petitioner to have an opportunity actually to earn the approved rate of return

(T 388-389). The attrition factors are computed in Petitioner's Exhibit 1, Section 7, Schedule 6 (T 389).

Staff witness Burkhardt also recognized attrition (T 496-499). He examined a 57-month period beginning in January, 1973, and ending in September, 1977, showing allowed returns and earned returns in Staff Exhibit 2, Schedule 21, and with a graphic portrayal in Schedule 22. The witness went on to say that if, during past years, as both Petitioner's and Staff's exhibits demonstrated, the Petitioner "has consistently been unable to earn the return authorized by the Commission, this fact should be considered" (T 497). Mr. Burkhardt also stated that the economic environment which produced past attrition should be compared with probable future circumstances (T 497). He listed five factors which he regarded as the primary determinants of attrition, and then concluded that he saw "no possibility for secession in new plant

additions, inflation or the continued issuance of new capital above embedded debt cost" (T 498). Furthermore, the witness agreed that the same factors which contributed to attrition in the past will probably persist in the future. Staff witness Burkhardt concluded by stating that the Commission could justifiably allow Petitioner a return increment to offset the effect of attrition (T 498-499).

The Commission's report and order made no mention of an attrition allowance. The absence of appropriate findings and conclusions by the Commission on the attrition issue made it impossible for the reviewing courts to determine whether the conclusions of the Commission were supported by competent and substantial evidence. As the Circuit Court concluded, Appendix D, p. 27:

> Insufficient findings and conclusions and lack of findings and conclusions in the Report and Order of respondent [Commission] deprive relator of due process under the provisions of Article V and XIV, Amendments to the United States Constitution. . . .

The Commission's failure to consider an attrition allowance in this case not only deprived Petitioner of its procedural right to findings and conclusions on this important issue, but the Commission's action also deprived Petitioner of any reasonable opportunity to earn a fair rate of return on the value of its property, as required to avoid confiscation of private property for public use without Due Process of Law, Bluefield Waterworks and Improvements Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 689-92, 43 S.Ct. 675, 677-79 (1923). This action of the Commission had the effect of arbitrarily approving confiscatory rates which amounted to public taking of private property without just compensation in violation of Petitioner's Fourteenth Amendment rights, Ibid. Even if there were some remote chance that the Petitioner could have earned the authorized rate of return, the rates set by the Commission without considering attri-

tion were arbitrary and were arrived at by a process which fell far short of affording Petitioner Due Process of Law. As Justice Cardozo observed with respect to an analogous issue in West Ohio Gas Company vs. Public Utilities Commission, 294 U.S. 79, 83, 55 S.Ct. 324, 325 (1935), "Present confiscation is not atoned for by merely holding out the hope of a better life to come."

II. The Missouri Court of Appeals' Dismissal of the Appeals for Mootness (on the ground that the rate order under review had been superseded by later orders) Deprived Petitioner of its Right to Judicial Review of the Attrition Allowance Issue, as Guaranteed by the Missouri Constitution, Article V, Section 18, and the Missouri Public Service Commission Law, Sections 386.510 and 386.540, R.S.Mo. 1978, and thereby Deprived Petitioner of Due Process of Law under the Fourteenth Amendment to the United States Constitution. The Exception to the Mootness Doctrine declared in Southern Pacific Terminal Company v. Interstate Commerce Commission, 219 U.S. 498 (1911), Should Be Applied to Judicial Review by State Courts of Orders of State Administrative Agencies as a Requirement of Due Process of Law under the Fourteenth Amendment to the United States Constitution.

In Southern Pacific Terminal Company

vs. Interstate Commerce Commission, 219 U.S. 498, 31 S.Ct. 279 (1911), the Court was asked to rule upon the lawfulness of an order of the Interstate Commerce Commission which required the Southern Pacific Company to cease and desist from granting a particular shipper of cotton seed products preferential treatment over similar shippers in the use of the Port of Galveston, Texas, for a period of two years. The Commission contended that because its order had expired, the case had become moot and should be dismissed. The Court rejected the Commission's contention, 219 U.S. at 515, 31 S.Ct. at 283:

> In the case at bar the order of the Commission may to some extent (the exact extent it is unnecessary to define) be the basis of further proceedings. But there is a broader consideration. The question involved in the orders of the Interstate Commerce Commission are usually continuing (as are manifestly those in the case at bar), and these considerations ought not to be, as they might be, defeated, by short-term orders, capable of repetition, yet evading review, and at one time the government, and at another time the

> carriers, have their rights determined by the Commission without a chance of redress.

In the Southern Pacific decision, the Court cited United States vs. Trans-Missouri Freight Association, 166 U.S. 290, 17 S.Ct. 540 (1897), wherein the Court had refused to dismiss as moot an appeal to determine the legality of an agreement between the railroads that allegedly violated the Sherman Act after the railroads had voluntarily terminated that agreement. In Trans-Missouri, the Court stated, 166 U.S. at 308, 17 S.Ct. at 546:

> The mere dissolution of the association is not the most important object of this litigation. The judgment of the court is sought upon the question of the legality of the agreement itself for the carrying out of which the association was formed, and if such agreement be declared to be illegal the court is asked, not only to dissolve the association named in the bill, but that the defendants should be enjoined for the future. . . .

The legality of an allowance for attrition, and the Commission's failure to rule that issue, will continue to be challenged

by Petitioner, because during a highly inflationary period, rate cases necessarily will be filed, one after another, in which that legal issue will be raised. Consequently, this rate proceeding is a classic justification rejecting the conclusion of mootness.

Appellate courts in the states of Michigan, Wisconsin, Massachusetts and Idaho have addressed the mootness issue in a rate case context and all have concluded that the appeals were not moot.

In Intermountain Gas Co. vs. Idaho Public Utilities Commission, 98 Idaho 718, 571 P.2d 1119 (1977), the Idaho Public Utilities Commission contended that Intermountain's appeal from the decision in a rate case entered in 1975 was moot because of a superseding order entered in a 1976 rate case. The Idaho Supreme Court rejected that contention, 571 P.2d at 1121:

> More importantly, Intermountain argues that the procedures questioned here

> present the classic case for review in that they create a recurring problem which, in the very nature of things, will always escape review. In today's inflationary economy, a later rate application will frequently have superseded the order in dispute before the Supreme Court's timetable permits appellate review thereof. We agree. The matters considered herein are of on-going importance to the operation of the Commission and procedural errors which we note can be avoided by the Commission in the future.

Petitioner is certainly confronted with an inflationary economy, as was Intermountain Gas, thus requiring frequent superseding orders for rate relief. The attrition allowance issue plainly is justiciable and constitutes a matter of ongoing importance that will recur in many future rate proceedings.

In Milwaukee & Suburban Transport Corp. vs. Public Service Commission, 268 Wis. 573, 68 N.W.2d 552 (1955), the Wisconsin Supreme Court was asked to rule upon the question of whether the depreciation method used by the Commission resulted in unreasonable and confiscatory fares. The Commission contended

that a superseding fare order rendered the appeal moot. Rejecting this contention, the Court stated, 68 N.W.2d at 556:

> The issue over the method of computation of depreciation presents a continuing controversy, which was not ended by the September 17, 1953 fare order being superseded by the 1954 fare orders, and therefore the controversy presented in the present review proceedings is not moot.

In Board of Gas and Electric Commissioners of Middleborough vs. Department of Public Utilties, 363 Mass. 433, 294 N.E.2d 866 (1973), the Court considered a challenge to the legality of a statute which authorized the Department to suspend the operation of certain utility rates for up to a 10-month period. Although neither party raised the mootness issue, the Court addressed the same after noting that the disputed suspension order had been revoked. The Court held, 295 N.E.2d at 868-69:

> It was represented by counsel that this is a frequently recurring question which should be answered to prevent further disagreements between municipal light

> boards and the Department. They represent further that it is very difficult to litigate the question to the point of presenting it to an appellate court for decision before the expiration or other termination of the suspension of the rate schedules by the Department. We recognize this practical difficulty and we conclude that we should now answer the questions and thereby eliminate or reduce further disagreements between governmental agencies on this subject. In two comparable situations the United States Supreme Court granted relief by describing them as truly "capable of repetition, yet evading review" by an appellate court. Southern Pac. Terminal Co. v. Interstate Commerce Comm., 219 U.S. 498, 515, 31 S.Ct. 279, 283, 55 L.Ed. 310, and Roe v. Wade, 410 U.S. 113, 93 S.Ct. 705, 35 L.Ed.2d 147.

The appellate courts in the State of Michigan have rendered particularly enlightening decisions in cases nearly identical to the case at bar. Michigan Bell Telephone Co. vs. Public Service Commission, 85 Mich. App. 163, 270 N.W.2d 546 (1978); General Telephone Company of Michigan vs. Michigan Public Service Commission, 78 Mich. App. 528, 260 N.W.2d 874 (1977). In Michigan Bell and General Telephone, the companies had filed

revised rate schedules and received some of the requested relief before the presentation of their appellate cases. Furthermore, in both cases, the companies conceded that General Telephone of Michigan vs. Public Service Commission, 341 Mich. 620, 67 N.W.2d 832 (1954), and Michigan Bell Telephone Co. vs. Public Service Commission, 315 Mich. 533, 24 N.W.2d 200 (1946), precluded them from receiving retroactive rate relief.

In General Telephone, the Court stated, 260 N.W.2d at 877:

> The Michigan Public Service Commission also has a statutory duty to provide just and reasonable rates . . . . (citation omitted) We think that the Commission has erred in this case and that such errors are likely to recur in the future unless this Court addresses certain issues raised by the parties.

In Michigan Bell, the Court stated with regard to the issue of mootness, 270 N.E.2d at 547-48:

> The circuit court rejected the Commission's theory for two reasons. First, the statutory scheme for rate setting

contemplates review of Commission determinations on appeal. M.C.L. §§460.4, 462.26; M.S.A. §§22.13(4), 22.45. Since it is Michigan Bell's practice to seek new rate determinations after each Commission decision, and since the appeal process generally takes longer than the Commission's resolution of each rate case, almost inevitably new rates will be set before the appeal on the old rates is decided. If the new rate determination rendered the contested issues in the old rate case moot, the review scheme would be rendered a nullity. Second, even assuming no relief could be granted in this case, the mootness doctrine has an exception permitting review where the issues involved are of continuing public interest, capable of repetition, yet also capable of evading review. See Southern Pacific Terminal Co. v. Interstate Commerce Comm., 219 U.S. 498, 31 S.Ct. 279, 55 L.Ed. 310 (1911), Alton & S.R.Co. v. International Ass'n of Machinists & Aerospace Workers, 150 U.S. App. D.C. 36, 43, 463 F.2d 872, 879 (1972).

The Commission made a similar mootness argument before this Court in the recent case of General Telephone Co. of Michigan v. Public Service Comm., 78 Mich. App. 528, 260 N.W.2d 874 (1977). In General Telephone, the utility conceded that a subsequent rate increase precluded relief in that particular case. As a consequence, this Court also assumed that the retroactivity doctrine would preclude relief. However, this Court reached the substantive issues presented under the second rationale advanced by the trial court in the instant case, the public

> interest exception to the mootness doctrine, because the errors were likely to recur in the future.
>
> The mootness issue presents two sub-issues. First, whether the substantive issues are moot because no relief can be granted in this case, and second, if moot, whether we may reach the substantive issues under the public interest exception to the mootness doctrine. Michigan Bell primarily argues the second sub-issue, but raises by implication the first sub-issue, since it requests that relief be granted in the instant case.
>
> Assuming mootness, the public interest exception clearly applies in this case. The BIS payments are ongoing expenditures which will be taken into account in future rate cases, and the amortization of the state income tax reserve will extend over five years. Unless we reach these issues in the instant case, they may never be resolved by the courts.

In the instant case, the Court of Appeals avoided deciding the constitutional question of the Petitioner's right to judicial review by implying that this case presented no legal issue not already determined by a fixed principle of law, and by characterizing the case as one involving only factual issues. Neither of those propositions is supportable on this record. This Court may ignore untenable

non-federal grounds, without fair and substantial support in the record, relied on by a state court as the basis for the state court's avoidance of review of a claim of federal right, Ward v. Love County, 253 U.S. 17, 22, 40 S.Ct. 419, 421 (1920).

Ruling that, "Because MPS [Petitioner] has been granted two rate increases since the Report and Order in question here, this case is now moot and the appeal is dismissed" (Appendix A, p. 8, 615 S.W.2d at 589), the Court of Appeals cited its own decision in State ex rel. Missouri Public Service Company vs. Pierce, 604 S.W.2d 623 (Mo.App. 1980), rendered last year. In that case, however, the Court of Appeals had held that the appeal should be dismissed for mootness because, "The points on appeal present no issue not already determined by a fixed principle of law," 604 S.W.2d at 625, a proposition which plainly is not applicable to the legal issue of first impression in the State of Missouri presented

on this record, i.e., whether an attrition allowance should be considered and approved if proven by uncontroverted, substantial and competent evidence in a utility rate case in the State of Missouri.

The Court of Appeals also held in the case at bar that, "This case presents only factual issues with no issue of public importance which requires determination when this case has become moot" (Appendix A, p. 8, 615 S.W.2d at 589), a proposition which plainly is untenable on the record in this case, and which is inapplicable to the legal issues involved herein, i.e., whether an attrition allowance should be considered and approved, if proven by uncontroverted, substantial and competent evidence, in a utility rate case in the State of Missouri, and whether the Commission can frustrate judical review of that issue by avoiding making findings of fact and conclusions of law regarding the recurring attrition allowance issue.

The central question in this case is whether the appellate courts of Missouri can avoid judicial review of important legal issues -- (a) the right of a utility to an allowance for attrition in a ratemaking case and (b) the failure of the Commission to make findings of fact and conclusions of law regarding the attrition allowance issue (judicial review of the Commission's orders being guaranteed by both the Missouri Constitution, Article V, Section 18, and the Public Service Commission Law, Sections 386.510 and 386.540, R.S.Mo. 1978) -- by construing the mootness doctrine so as to prevent judicial review of those issues in every rate case in which the rate subject to review has been superseded by a new rate, even though the attrition allowance issue is one which is bound to be repeated in substantially all rate cases coming before the Commission.

To assert, as the Court of Appeals did in State ex rel. Kansas City Power & Light Company v. Public Service Commission of Missouri, 615 S.W.2d 596 (Mo.App. 1981), (cited by the Court of Appeals in the instant case, Appendix A, p. 8, 615 S.W.2d 587, 589) -- that the question whether an attrition allowance should be permitted is merely one of many variables in any given case which is to be resolved by the Commission as a question of fact -- begs the real question here, i.e., the legal issue of whether an attrition allowance may ever be approved by the Commission. The only ground for review raised in Kansas City Power & Light Company regarding attrition was whether the Commission's findings were supported by substantial and competent evidence. No issue was raised, as here, regarding the failure of the Commission to make findings and conclusions. If there was either insufficient or controverted evidence respecting an allowance for attrition in the Kansas

City Power & Light Company case, so that the reviewing court could defer to the Commission's factual determination of that issue, the Court of Appeals' decision in the Kansas City Power & Light Company case has no application to the instant case, in which there was substantial, uncontroverted and competent evidence of both the fact of attrition and the quantifiable effect thereof. In this case, however, because the Commission failed in its statutory duty to make findings of fact and conclusions of law as to whether an attrition allowance should be approved, neither the Petitioner, nor the reviewing courts had any way of knowing whether the Commission did or did not include an attrition allowance in its approved rate of return, or whether the Commission rejected inclusion of an attrition allowance as a matter of fact finding, or whether the Commission concluded as a matter of law that an attrition allowance should not be permitted in Missouri rate cases, or, for that matter,

whether the Commission gave any consideration at all to the attrition allowance issue. All the Petitioner and the reviewing courts could discern from the Commission's Report and Order was that the Commission had given no articulated consideration to the attrition allowance issue. Whether an attrition allowance should be approved in this case, on a record containing uncontroverted, substantial and competent evidence supporting the allowance, is a question of law, not of fact. Moreover, it is a unique question of first impression in Missouri, which the appellate courts should not be permitted to avoid deciding by a strained application of the mootness doctrine. Dismissal for mootness and failure to review the attrition allowance issue under these circumstances denies Petitioner Due Process of Law, as guaranteed by the Fourteenth Amendment to the United States Constitution.

The right to an allowance for attrition on these facts presents an important legal

issue of undeniable public interest which necessarily is continuing and recurring in nature. During the period of increasing inflation in the 1970's, more and more state rate-making bodies recognized the importance of the issue and authorized an attrition allowance. To date, the courts and agencies in at least 21 states have ruled that, when supported by competent and substantial evidence, an allowance for attrition is required (Respondent's Brief in the Court of Appeals, pp. 83-89 and appendix thereto). The most often-cited reasons for allowing an adjustment for attrition are: (1) the rates set for a utility company need to allow it to earn a fair rate of return for a reasonable period of time in the future; (2) the continued erosion of a public utility's earnings is against public interest insofar as poor earnings require a utility to go into the money market in a disadvantageous position; and (3) the continued inability of a utility to earn a fair

rate of return causes new rate cases to follow closely upon the heels of the previous rate increase. Narragansett Electric Company vs. Harsch, 117 R.I. 395, 368 A.2d 1194, 1208-09 (1977). In Narragansett Electric Company, the Supreme Court of Rhode Island took notice of the trend in state regulatory bodies allowing an adjustment for attrition, stating that, 368 A.2d at 1203:

> While recognition of erosive trends is a relatively recent development, it is now generally conceded that where such attrition has been clearly demonstrated by a utility company, an adjustment to that company's rate of return is appropriate.

The New York Court of Appeals stated the general principle in this fashion:

> Where there is a great disparity between the predicted rate of return found necessary by the Commission and the return actually earned, a suitable adjustment should be made to reflect the attrition . . . that has taken place. . . . . "'Experience'--how much better this is than expert testimony, whether in dealing in history or prophecy." (citation omitted)

New York Telephone Company vs. Public Service

Commission, 29 N.Y.2d 164, 272 N.E.2d 554, 557 (1971).

Some opponents have claimed that an allowance for attrition should not be provided because it is too difficult to quantify. The Florida Public Service Commission specifically rejected this position in a particularly enlightened opinion:

> In authorizing this allowance, we are cognizant of arguments by public counsel that better procedures are necessary in order to measure the future attrition of the company in a meaningful fashion. The quantification of future attrition can be nothing more than informed judgment on the part of the person attempting to predict this occurrence. As a matter of fact, no party has suggested a way or means by which to predict accurately future attrition. However, as long as inflation remains a part of our economy, the phenomenon of attrition will continue to occur. This is an indisputable fact of life. No one questions the fact that attrition (or accretion) occurs and that it affects public utilities, including General Telephone Company. The evidence herein reflects it has occurred for a number of years, and has resulted in General failing to achieve its authorized rate of return. There are no simple answers or solutions to the problem. However, the fact that future attrition is difficult to

> measure should in no way deter us from attempting to provide some reasonable solution to the historical effects of earnings erosion.

Re: General Telephone Company of Florida, 19 PUR 4th 227, 234-35 (Fla. P.S.C. 1977).

The Commission's Staff and Petitioner offered uncontradicted evidence that attrition had occurred with respect to the previous rates of return authorized by the Commission for the Petitioner (T 388-389; Petitioner's Exhibit 1, Section 7, Schedule 2; T 496-497; Staff Exhibit 2, Schedules 21, 22). Staff witness Burkhardt pointed out the following five principal factors that contribute to attrition: (1) declines in kilowatt-hour sales growth; (2) new plant additions; (3) inflation; (4) increases in fixed capital costs; and (5) operational difficulties with generation plant (T 497-498). He further indicated that he saw no indication that these factors would not continue in the future (T 498-499).

Thus, in this case the Commission had before it uncontroverted evidence as to Petitioner's history of attrition and that it was probable that Petitioner would continue to experience attrition. Yet, the Commission did not even mention the issue of attrition in its report and order. As stated by the Wisconsin Public Service Commission:

> Under these circumstances it is both necessary and reasonable and just that an attrition allowance be included in electric utility revenue requirement for this proceeding so as to afford applicant a truly reasonable opportunity to earn the rate of return authorized here.

Re: Wisconsin Michigan Power Company, 15 PUR 4th 488, 495-496 (Wis. P.S.C. 1976).

In authorizing rates that will give a utility an opportunity to earn a fair rate of return, the Commission is required to exercise "fair and enlightened judgment, having regard to all relevant facts." Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 692, 43 S.Ct. 675, 697 (1923). Among those

relevant facts is the actual experience of the utility, Smith vs. Illinois Bell Telephone Co., 282 U.S. 133, 160, 51 S.Ct. 65, 73 (1930), because: "Elaborate calculations which are at war with realities are of no avail." Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 150, 164, 54 S.Ct. 658, 663 (1934). On this record, attrition was proven to be a matter of Petitioner's experience and an undeniable reality which Petitioner could not avoid. If the right to judicial review in these circumstances is more than an ephemeral hope, it requires that the appellate reviewing courts not avoid consideration of this highly justiciable issue by declining to review the case for mootness.

CONCLUSION

The Court should review this case because the question -- whether the principle of justiciability of recurring legal issues involved in superseded short-term orders of adminis-

trative agencies, which if judicial review were declined for mootness would evade judicial review, declared in Southern Pacific Terminal Company vs. Interstate Commerce Commission, 219 U.S. 498 (1911), should be extended to the states as a requirement of Due Process of Law under the Fourteenth Amendment -- is a question of substantial importance, which has never been, but should be, settled by this Court. For these reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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Appendix

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No. 81-468

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1981

STATE OF MISSOURI, ex rel. MISSOURI PUBLIC SERVICE COMPANY,

Petitioner,

vs.

CHARLES J. FRAAS, Chairman, Commissioners, HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK McCARTNEY, and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,

Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1981

STATE OF MISSOURI, ex rel., MISSOURI PUBLIC SERVICE COMPANY,

Petitioner,

vs.

CHARLES J. FRAAS, Chairman, Commissioners HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK McCARTNEY, and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,

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APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

APPENDIX A

MISSOURI COURT OF APPEALS

WESTERN DISTRICT

No. WD 31,537

STATE OF MISSOURI, ex rel. MISSOURI PUBLIC SERVICE COMPANY, a Missouri corporation,

Relator-Appellant-Respondent,

v.

CHARLES J. FRAAS, Chairman, Commissioners HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK McCARTNEY, and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,

Respondent-Appellant.

APPEAL FROM THE CIRCUIT COURT
OF COLE COUNTY, MISSOURI

OPINION FILED: March 30, 1981

Before Pritchard, P.J., and Turnage and Clark, JJ.

Missouri Public Service Company filed tariffs with the Public Service Commission calling for an increase in gas and electric rates in August 1977. Following hearings,

the Commission issued its report and order in June 1978 in which the Company was granted increases but not as much as it sought. On appeal to the circuit court the report and order was affirmed in part and reversed in part. The circuit court reversed as to the finding of the Commission on return on equity, as to the depreciation reserve allowance, as to consumer usage annualization and attrition allowance by finding that the order as to those items was unsupported by the evidence, and, as to the latter, the Commission did not make adequate findings of fact. Both the Commission and MPS have appealed. The Commission appeals from that part of the circuit court judgment which reversed part of the report and order and MPS appeals that part of the judgment which affirms the report and order. On this appeal the Commission, although appealing, contends the issues have become moot because

MPS has been granted two permanent rate increases since the report and order in question here was issued. Appeal dismissed.

MPS concedes the case would be moot because of the later rate increases but contends this case presents important legal issues of public interest which are likely to recur and which would not otherwise be reached by an appellate court. An examination of these issues raised by MPS will demonstrate that no such issues are present.

The first issue raised on this appeal by MPS relates to the treatment of certain tax expenses which is cast in terms of the "flow-through" or "normalization" treatment by the Commission. Briefly, the "flow-through" treatment would require MPS to charge as an operating expense only the amount of taxes actually paid to the government. The "normalization" method would

allow MPS to charge as expenses the amount of taxes which it would have paid without regard to certain accounting practices which reduced the actual amount of taxes paid in certain years. This question was dealt with by this court in State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 606 S.W.2d 222 (Mo.App. 1980). In that case this court held basically that whether or not a utility is allowed to use the "normalization" method or the "flow-through" method of calculating the amount of taxes which will be charged as expenses is a matter left in the first instance to the utility and in the second instance is a question for the Commission. This court held the question involves a question of fact as to whether or not the utility should forego a tax benefit and use the "flow-through" method if other considerations outweighed the tax advantage to

be gained by normalization. 606 S.W.2d at 226.

In this case the Commission utilized the "flow-through" method after hearing evidence concerning MPS's cash flow situation, interest coverage and percentage of internally generated funds. The Commission decision in this case was a purely factual one, unrelated to any general holding on the use of "flow-through" or "normalization." Thus a full discussion in this case would focus on the purely factual matters presented and decided. Such factual matters are not the sort of questions to be decided after a case becomes moot. There is nothing to suggest that this subject requires discussion beyond that in Utility Consumers Council, supra.

MPS next contends the Commission refused to allow a return on the amount of compensating bank balances MPS was required to

maintain by certain banks which offered MPS short term credit. This was a question of fact which was determined by the Commission and does not present any question of importance which must be resolved or escape appellate resolution.

MPS contends the Commission erred in the manner in which it calculated the maintenance expenses incurred by MPS on its Sibley power plant. Again, this was a question of fact and does not present any matter of great importance which requires determination.

MPS finally contends that the Commission erred in failing to allow certain rate base additions incurred in the installation and activation of equipment up through the date the report and order was adopted by the Commission. Again, this was a question of fact which does not present a question of such importance as to require decision when

the case has become moot.

MPS also urges this court to determine the "attrition allowance" question as a matter of great importance which must be determined even though the case is concededly moot. "Attrition allowance" is discussed in State ex rel. Kansas City Power & Light Company v. Public Service Commission of Missouri, 615 S.W.2d 596 (Mo.App. 1981) [No. WD 31,821 adopted concurrently herewith] and there determined that this is not a unique principle which requires adjudication.

This case presents only factual issues with no issue of public importance which requires determination when this case has become moot. State ex rel. Gas Service v. Public Service Commission, 536 S.W.2d 491, 493 (Mo.App. 1976). Because MPS has been granted two rate increases since the report and order in question here, this case is now moot and the appeal is dismissed.

State ex rel. Missouri Public Service Company v. Pierce, 604 S.W.2d 623 (Mo.App. 1980).

All concur.

William E. Turnage,
Judge

APPENDIX B

MISSOURI COURT OF APPEALS
WESTERN DISTRICT
KCD No. 31537

DATE: May 4, 1981
IN RE: State ex rel. Mo. Public Service vs. Fraas, et al.

ORDER DENYING MOTIONS FOR REHEARING AND FOR TRANSFER

Motion for rehearing and (or) transfer to Supreme Court overruled and denied.

APPENDIX C

IN THE SUPREME COURT OF MISSOURI
Supreme Court No. 63092
Western District No. 31537

May Session 1981

State ex rel. Missouri Public Service Company, a Mo. corp.,

Relator-Appellant-Respondent,

vs.

Charles J. Fraas, Chairman, et al., as members of and constituting the Public Service Commission of Mo.,

Respondent-Appellant.

ORDER AND JUDGMENT DENYING APPLICATION TO TRANSFER TO SUPREME COURT OF MISSOURI

Now at this day, on consideration of Relator-Appellant-Respondent's Application to transfer the above entitled cause from the Western District Court of Appeals, it is ordered that said application be, and the same is hereby denied.

STATE OF MISSOURI--SCT.

I, THOMAS F. SIMON, Clerk of the Supreme Court of the State of Missouri, certify that the foregoing is a full, true and complete transcript of the judgment of said Supreme Court, entered of record at the May Session

thereof, 1981, and on the 8th day of June, 1981, in the above entitled cause.

Given under my hand and seal of said Court, at the City of Jefferson City, this 8th day of June, 1981.

Thomas F. Simon, Clerk.

APPENDIX D

IN THE CIRCUIT COURT OF COLE COUNTY, MISSOURI

Division 2

Case No. 30,618

STATE OF MISSOURI ex rel. MISSOURI PUBLIC SERVICE COMPANY, a Missouri corporation,

Relator,

vs.

CHARLES J. FRAAS, JR., Chairman, Commissioners HUGH A SPRAGUE, STEPHEN R. JONES, LEAH BROCK McCARTNEY and ALBERTA C. SLAVIN, as members of and constituting the PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI,

Respondents.

FINDINGS, CONCLUSIONS AND JUDGMENT

This cause having been submitted upon

briefs and oral argument and being before the Court under the provisions of §386.510, V.A.M.S., now on this 19th day of December, 1979, the Court once again takes up the matter and, being fully advised in the premises, finds, concludes and adjudges as follows:

Preliminary Matter

Respondent and intervenor have moved to dismiss this review proceeding in its entirety on the ground of mootness allegedly resulting from increases in both electric and gas rates authorized since the instant case was heard and decided by respondent.

The motion is not well taken. The Court finds that, while such increases in electric and gas rates have been authorized and implemented since the instant appeal, a finding of mootness now would effectively deny relator judicial review, particularly when regulatory lag and the time required

for judicial review are considered, together with recent and current economic conditions which mandate successive rate cases with little time intervening. Moreover, the instant appeal presents important legal issues of public significance which are likely to recur and which could not otherwise be reached upon appeal and review if the mootness doctrine is invoked. Gas Service Company v. Public Service Commission, 536 SW 2d 491, 493 (Mo.App. 1976); Laclede Gas Company v. Public Service Commission, 535 SW 2d 561, 565 (Mo.App. 1976). The issues here need to be considered, determined and, hopefully, set at rest, State ex rel. Utility Consumers Council, etc., v. Public Service Commission, 585 SW 2d 41 (Mo. banc 1979); Reser v. Rush, 562 SW 2d 365 (Mo. banc 1978).

The joint motion to dismiss should be and is hereby denied.

Findings

1.

This is a timely perfected review of an order of respondent in consolidated electric and gas rate cases initiated by relator.

2.

Respondent determined that the allowed return on equity for relator should be 12.70%, which converts, with the stipulated capital structure, to a return on net original cost rate base of 9.04%. Respondent further determined that relator's common equity should sell at a price that is approximately 1.06 times its book with the approved return on equity.

These conclusions are erroneous and unsupported by competent and substantial evidence. Substantial issues relating to the return on equity and rate of return are ignored and left unresolved. The findings of respondent beginning at the

bottom of page 3 of the Report and Order and concluding near the center of page 4 fail to disclose the basis upon which respondent concluded that the 12.70 return on equity is appropriate.

Moreover, and more flagrant, it is impossible to determine whether an attrition allowance was included or excluded. Such an allowance is calculated to offset inflationary factors leading to a failure to earn an allowed rate of return and, in effect, confiscation of relator's property. The evidence respecting the need for and appropriateness of an attrition allowance was undisputed by both company witnesses and the responsible staff witness. This evidence discloses that the economic environment has prevented relator from earning the authorized return for a number of years and that these same environmental factors will persist in the future. To deny relator an attrition allowance under

the record in this case insures a denial of an opportunity to earn a reasonable rate of return upon invested capital. This is confiscation.

Respondent ignored issues respecting preoffering pressure and flotation costs. There was no staff evidence respecting the presence or absence of preoffering pressure. Relator's evidence on this issue was undisputed.

The evidence respecting flotation costs was disputed. One need only refer to the reports and orders in the two immediately preceding electric rate cases before respondent, Case No. ER-77-118, Kansas City Power & Light Company, and Case No. ER-77-154, Union Electric Company, for instances where such issues have been raised, considered and decided. Further, it is difficult to reconcile the results in those two cases with a denial of preoffering pressure in this instance.

Respondent's conclusion respecting return on equity, by design or by chance, coincides with the midpoint of a range recommended by the staff witness. If respondent's conclusion respecting return on equity was by design at the midpoint of this witness' range (and the Report and Order does not reveal this), it must fail. The staff witness' conclusion was based solely upon a statistical and mechanical approach. He denied using his own perception of risk and value, relied exclusively upon this statistical device described as a multiple regression model and did not exercise his own independent judgment.

This statistical device was based upon outdated information and its use cannot be reconciled with its use in the two immediately preceding electric rate cases identified above. Further, the witness employed hypothetical values in applying the

device to relator. These values included an assumed cash dividend of $1.32 with a 67.5% payout on earnings of $1.96, all of which were without foundation in the evidence and, indeed, were contrary to the undisputed evidence. Artifically determined and selected cash dividends and payout ratios were rejected by respondent in the two immediately preceding electric rate cases.

This approach required that the company's long established stock dividend policy be ignored, notwithstanding its approval initially in 1956 and its subsequent approval annually or semi-annualy ever since 1956 by respondent.

This approach also required that the lower than average equity ratio of relator be ignored. This is without foundation in the record. There is no competent and substantial evidence to support a conclusion that the equity ratio is not a factor to be con-

sidered in determining risk and, thus, a reasonable return on equity.

Respondent made no effort to support or explain its conclusions respecting the stock dividend and the equity ratio. To the extent that respondent relied upon the staff witness' testimony for respondent's conclusion respecting return on equity, the conclusion is erroneous because of the defects in the staff witness' statistical analysis.

Inasmuch as the 12.7 return on equity approved by respondent is nearly twice the approximately 7% return on equity being realized by relator shortly before the Report and Order, which 7% return can hardly be significantly improved by the small increase granted, there is little or no opportunity in reality for relator to reach the approved return on equity, even if it be assumed to be reasonable and compensatory. This, too, is confiscation.

3.

Respondent concluded that relator should be allowed to normalize only the tax timing differences related to accelerated depreciation, repair allowances, investment tax credit and injuries and damages reserve. This conclusion is supported by competent and substantial evidence and the basis for this conclusion is articulated adequately.

4.

Respondent concluded that relator's depreciation reserve account at June 30, 1978 (a test year ending October 31, 1977, adjusted for known and measurable items through June 30, 1978, was employed by agreement), should be increased by one-half of the company's annualized depreciation expense at June 30, 1978. This conclusion is erroneous and is unsupported by competent and substantial evidence. Such an adjustment as that adopted by respondent will produce an inadequate return

if, as the undisputed evidence discloses, relator continues to invest in more plant during the first year rates are in effect.

5.

Respondent concluded that it should refuse to place $2,816,985 of compensating bank balances in relator's electric rate base and $245,564 in relator's gas rate base. These conclusions are supported by competent and substantial evidence and are adequately explained in the Report and Order.

6.

Respondent concluded that relator's cash working capital requirement should be determined by use of the lead-lag analysis performed by the staff with certain offsets. These conclusions are supported by competent and substantial evidence and are adequately explained.

7.

Respondent concluded that a customer usage annualization adjustment to reflect increased usage per customer should be made while, at the same time, rejecting the identical adjustment in the gas case. The adjustment in the electric case is erroneous and not supported by competent and substantial evidence. Furthermore, it is inconsistent with the implicit conclusion respecting the depreciation reserve issue that relator would make no additions to plant during the first year of the new rates (which implicit conclusion is unsupported by competent and substantial evidence).

8.

Respondent concluded that relator incorrectly interpreted and applied the fuel adjustment clause prescribed by respondent and, as a result thereof, imposed an offset in that amount against coal

costs. This is unlawful and constitutes retroactive ratemaking. Further, respondent's fuel adjustment clause was subject to the interpretation placed upon it by relator and, in any event, no overcharge is appropriate in view of relator's return on equity of less than 9% during the year in question when it was utilizing rates projected by respondent to produce an approved return on equity of 14%.

9.

Respondent concluded that the relationship of oil generation to purchased power was changing and that it would not be appropriate to use the percentage of oil generation which obtained during the test year and that the change should be given effect by a percentage increase to the test year level. These conclusions are supported by competent and substantial evidence and are adequately explained.

10.

Respondent concluded that $574,000 should be allowed for operation and maintenance expenses at Jeffrey Unit No. 1. This conclusion is supported by competent and substantial evidence and is adequately explained.

11.

Respondent concluded that a three-year weighted average should be utilized for determining a proper maintenance expense allowance for relator's Sibley Unit 3 Generating Station. This conclusion is supported by competent and substantial evidence and is adequately explained.

12.

Respondent concluded that it would not accept relator's adjustment to gas revenues for anticipated customer conservation. This conclusion is supported by competent and substantial evidence and is adequately

explained.

13.

Respondent concluded that there was insufficient evidence to support relator's proposed economic depreciation rates for its gas plant in service. This conclusion is supported by competent and substantial evidence and is adequately explained.

14.

Respondent concluded that it would not accept rate base additions proposed in relator's Exhibit 51. This conclusion is supported by competent and substantial evidence and is adequately explained.

Conclusions

1.

This Court has jurisdiction to determine the lawfulness and reasonableness of the Report and Order of respondent at issue herein.

2.

Relator has the burden of showing by clear and convincing evidence that the Order of respondent is unreasonable or unlawful. Relator has met this burden.

3.

The purported findings and conclusions in the Report and Order are insufficient in that they fail to decide live, contested and controlling issues and fail to disclose how live, contested and controlling issues were decided. Section 563.090 [536.090], V.A.M.S.; State ex rel. St. Louis Public Service Company v. Public Service Commission, 291 SW 2d 95, 98 (Mo. 1956); Iron County v. State Tax Commission, 480 SW 2d 65 (Mo. 1972); Stephen v. State Tax Commission, 499 SW 2d 798 (Mo. 1973); St. Louis County v. State Tax Commission, 515 SW 2d 446 (Mo. 1974); Century State Bank v. State Banking Board, 523 SW 2d 856 (Mo.App. 1975).

4.

Insufficient findings and conclusions and lack of findings and conclusions in the Report and Order of respondent deprive relator of due process under the provisions of Article V and Article XIV, Amendments to the United States Constitution, and Article I, §§10 and 26, Constitution of Missouri.

5.

Erroneous findings and conclusions, insufficient findings and conclusions, and lack of findings and conclusions in the Report and Order of respondent result in the confiscation of relator's property and take relator's property for public use without just compensation in violation of Article V and Article XIV, Amendments to the United States Constitution, and Article I, §26, Constitution of Missouri. Federal Power Commission v. Hope Natural Gas Company, 320 US 590 (1944); Bluefield Waterworks and Improvement Company v. West Virginia Public

Service Commission, 262 US 679 (1923); Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission, 262 US 276 (1923); United Railway and Electric Company v. West, 280 US 234 (1930); State ex rel. Missouri Water Company v. Missouri Public Service Commission, 308 SW 2d 704 (Mo. 1957).

WHEREFORE, IT IS ORDERED, ADJUDGED AND DECREED that the Report and Order of respondent issued June 23, 1978, in Case Nos. ER-78-29 and GR-78-30, is set aside and reversed and remanded to respondent for further action to comply with the findings and conclusions herein.

Byron L. Kinder
Judge

Dated this 19th day of December, 1979.

APPENDIX E

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. ER-78-29

In the matter of Missouri Public Service Company of Kansas City, Missouri, for authority to file tariffs reflecting increased rates for electric service to its customers in the Missouri service area of the company.

CASE NO. GR-78-30

In the matter of Missouri Public Service Company of Kansas City, Missouri, for authority to file tariffs reflecting increased rates for gas service to its customers in the Missouri service area of the company.

REPORT AND ORDER

On the 4th day of August, 1977, the Missouri Public Service Company (hereinafter called the Company) filed with this Commission revised electric rate schedules designed to increase the Company's billed jurisdictional electric revenues $18,723,097 annually, not including the resulting increase for franchise and occupational taxes or the recovery of lag in fuel adjustment.

On the same date, the Company submitted to the Commission revised gas rate schedules designed to increase the Company's billed jurisdictional gas revenues $2,167,137 annually, not including the resulting increase in franchise and occupational taxes. The Company gave the revised electric and gas rate schedules (hereinafter, revised schedules) an effective date of September 6, 1977. The Commission accepted the revised schedules for filing on August 10, 1977.

On August 15, 1977, the Commission suspended the revised schedules for 120 days beyond September 6, 1977, to January 4, 1978, and ordered the Company to file minimum filing requirements by November 1, 1977. On September 13, 1977, the Commission further suspended the revised schedules for six months from January 4, 1978, to July 4, 1978.

On September 13, 1977, the Commission

also set October 13, 1977, as the date for interventions; November 1, 1977, as the date by which Company was to file and serve its prepared testimony and exhibits; February 13, 1978, as the date by which the Commission Staff (hereinafter, Staff) was to file and serve its prepared testimony and exhibits; February 24, 1978, as the date by which each intervenor was to file and serve prepared testimony and exhibits; March 6, 1978, as the date by which interrogatories or requests for information were to be tendered; March 6, 1978 as the date for the prehearing conference to begin; and, March 20, 1978, as the date for the hearing to begin.

On November 1, 1977, in response to a request from Company, the Commission changed the dates for tendering interrogatories and information requests upon the Company from March 6, 1978, to January 10, 1978, and upon the Staff from March 6, 1978, to

February 23, 1978. On November 1, 1977, the Commission also directed Company to comply with 4 CSR 240-2.110(12) during its December 1977 billing cycle.

On November 28, 1977, the Commission ordered local hearings to be held on February 15, 1978, at Blue Springs, Missouri, and on February 16, 1978, at Raytown, Missouri. On February 1, 1978, the Commission ordered an additional local hearing to be held on February 15, 1978, at Clinton, Missouri.

Also on November 28, 1977, in response to a request from the Company, the Commission granted Company an extension, to its January 1978 billing cycle, to comply with 4 CSR 240-2.110(12).

On November 1, 1977, the City of Kansas City, Missouri (hereinafter, Kansas City) filed an application to intervene in Case No. ER-78-29. On November 29, 1977, Jackson

County, Missouri (hereinafter, Jackson County) filed an application to intervene in Case No. ER-78-29. These applications were granted on March 7, 1978, during the course of the prehearing conference.

On November 1, 1977, the Company filed and served its prepared testimony and exhibits, with the exception of the testimony and exhibits sponsored by Dr. van Poollen which, with leave of the Commission, were filed and served on January 6, 1978.

On January 10, 1978, the Public Counsel served interrogatories upon the Company. Company answered those interrogatories on February 10, 1978.

On February 14, 1978, the Staff filed and served its prepared testimony and exhibits with the exception of the testimony and exhibits of Matisziw, Persinger, Burkhardt and Proctor which, with leave of the Commission, were filed and served on

February 17, 1978.

Pursuant to the Commission's orders of September 13, 1977 and February 1, 1978, local hearings were held on February 15 and 16, 1978.

Also pursuant to the Commission's order of September 13, 1977, a prehearing conference was begun on March 6, 1978. Representatives of the Staff, Company, Public Counsel, Jackson County and Kansas City attended the prehearing conference.

At the prehearing conference the parties agreed to utilize as a test year the year ended October 31, 1977, as adjusted for known and measurable items through June 30, 1978, subject to Paragraph VI, D(2) of the hearing memorandum prepared by the parties and received at the hearing as Joint Exhibit No. 1. The parties also agreed to delineate for the Commission those ares of conflict which after the

prehearing conference continued to exist between all or some of the parties, and the order in which those areas of conflict and the witnesses sponsoring or opposing them would be presented.

Findings and Conclusions

The hearing on revised rate schedules for electric and gas heretofore filed by Company began on April 4 and concluded on April 27, 1973. After consideration upon all issues and contested matters, based upon competent and substantial evidence upon the whole record, the Commission finds and concludes as follows. (The findings and conclusions are limited to those issues remaining contested after the prehearing conference as reflected by Joint Exhibit No. 1.)

1. Rate of Return. The appropriate capital structure for the purpose of this case is as follows:

Type of Capital	Capitalization Ratio	Cost	Weighted Cost
Common Equity	30.00%	12.70%	3.81%
Preferred & Preference Stock	16.00	8.624	1.38
Long Term Debt	54.00	7.129	3.85
	100.00%		
Return on Rate Base			9.04%

The Company's common equity should sell at a price that is approximately 1.06 times its book value. That price level will permit the Company to pay cost of issuance as well as underwriters' commission and still receive proceeds exceeding book value from the sale of common stock. The Commission is of the opinion and finds that a rate of return on common equity of 12.70 percent is appropriate to achieve that market price.

The Company's stock dividend policy is a matter wholly within the Company's managerial and financial discretion and the Company should be treated no differently

than any other electric company merely because of that stock dividend policy.

The Company's low equity ratio is also a matter within the discretion of the Company's management, however, that equity ratio has no substantial effect upon the expectations of investors, and the Company's authorized rate of return should not be adjusted merely for the fact that the Company has a lower equity ratio than the electric industry as a whole.

The Commission concludes that the return to the equity owners should be commensurate with returns on investments in other enterprises having corresponding risks and should be sufficient to assure confidence in the financial integrity of the enterprise in order for it to maintain credit and attract capital. Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591 (1944). The Company is not,

however, entitled to returns such as that anticipated in highly profitable or speculative ventures. Bluefield Waterworks and Improvement Co. v. West Virginia Public Service Commission, 262 U.S. 679 (1923). A return on equity of 12.70 percent and a return on net original cost rate base of 9.04 percent will meet those requirements.

2. Allocation. There are three significant differences between the Staff and Company concerning allocation of plant and fixed expenses to jurisdictional and nonjurisdictional customers and two such differences related to allocation of variable expenses. The Company in allocating plant and fixed expenses included in its total system demand the demands of interchange and the demands of its Richard and Hume system, while the Staff did not. In addition, the Company placed the entire burden of the cost of its 15 percent reserve

requirement of the Mo-Kan Power Pool contract upon the jurisdictional customers, while the Staff allocated that cost between jurisdictional and nonjurisdictional customers. In addition, the Company's allocation factor was not based upon test year data but was based on the year 1976.

Since none of the energy supplied to the Company's Richard and Hume system is generated by the Company, the Staff's position in that respect would appear to be sound. Because interchange sales are a byproduct of the Company's generating capacity and the Mo-Kan Power Pool includes jurisdictional demand in computing the Company's 15 percent reserve requirement, the Staff's allocation would further appear to be the sound approach. Many of the components comprising both expenses and rate base claimed by the Company would therefore be reduced and the initial elec-

tric rate base agreed to by Company and Staff would be adjusted according to the Staff allocation to $202,067,286, and the Staff's and Company's agreed initial net operating income under the Staff's allocation would be $18,740,505 for electric service.

Since the allocation issue pertains only to the electric case it does not affect the Company and Staff's initial agreed rate base in the amount of $12,024,834, and the initially agreed upon net operating income of $970,948 for gas service during the test year as adjusted.

The Commission concludes that energy consumed which is not generated by the Company's system should not be used as factors in allocation of the Company's variable expenses or plant and fixed expenses. Allocation factors are proper and equitable that exclude part of the Company's variable expenses or plant and fixed

expenses attributed to energy consumed but not generated by the Company's system, and allocation factors should be used which fairly distribute the cost and benefit of interchange sales and the cost of the Company's reserve requirement between jurisdictional and nonjurisdictional customers.

3. Customer Deposits. Although the Company in its prefiled testimony included customer deposits in its capital structure, the capital structure recommended by both the Company and the Staff following the prehearing conference did not include customer deposits. The Company actually had deposits from its electric customers at the end of the test period of $1,781,836 and deposits from its gas customers for the same period in the amount of $344,732. The Staff's calculated rate base should be lowered by those amounts.

Customer deposits have a lower cost

(six percent) than the Company's overall capital cost, and if they had been placed in the capital structure the overall rate of return would have been lowered, and if customer deposits are used as an offset to rate base, the Company's net operating income should be reduced because those funds do have a cost of six percent. The electric customer deposits would cost $106,910 in interest, and gas customer deposits would cost $20,684 in interest; therefore, the net income for gas and electric service, as calculated by the Staff, should be reduced in those amounts.

The Commission concludes that it is reasonable and proper to use customer deposits as an offset to rate base when those deposits are not included in the capital structure, and since those funds have a six percent cost, it is reasonable and proper to reflect that cost by reducing net operat-

ing income by multiplying the cost by the amount rate base is reduced.

4. Income Taxes - Normalization. Some of the Company's former financial problems have abated to the extent that it no longer needs a full normalization. Normalization requires rate payers to pay $2 for every $1 of approved cash flow.

The average ratio of internally generated funds to construction budget for the electric utility industry during 1976 to 1977 was in a range from 35 percent to 40 percent. The Company's internally generated funds ration for 1976 was 66.4 percent, and for 1977 the ratio was 58.6 percent.

If in 1977 the Company had normalized only the tax timing differences related to accelerated depreciation, repair allowance, investment tax credit, and injuries and damages, its internally generated funds ratio would have been 48.1 percent, and if it had

called in its Series "U" Bonds, it would have been able to meet its indenture requirements for the sale of bonds.

If the Company earns an average return on equity of 12.0 percent in 1978, 1979 and 1980, and if it is allowed to normalize only the tax timing differences related to accelerated depreciation, repair allowance, investment tax credit, and injuries and damages, its minimum internally generated funds ratio will be 41.1 percent. The Company is of the opinion that its income tax expense should be increased by $1,928,592 for electric and $45,727 for gas. Since the Staff's proposed partial normalization of tax timing differences is correct no adjustment to the Staff's adjusted operating income is proper.

The Commission concludes that adequacy of cash flow, interest coverage and internally generated funds, as opposed to tax

deferral versus tax savings, should determine the extent to which a company is permitted to normalize tax timing differences, and interest coverage is adequate, for purposes of determing the extent to which normalization should be permitted, if it equals or exceeds indenture requirements for the sale of bonds.

Internally generated funds and cash flow are adequate if they are sufficient in conjunction with prudent financing measures to fund a company's construction program, and an internally generated funds ratio at or above the average for the electric utility industry is an indication of adequate internally generated funds.

The Company's cash flow, interest coverage, and internally generated funds will remain adequate if it is allowed to normalize only the tax timing differences related to accelerated depreciation, repair allowances, investment tax credit, and

injuries and damages.

5. Rate Design.

a. Electric. Company proposes to maintain its traditional declining block rate structure which grants promotional summer rates for all-electric customers under which they would pay less per kilowatt hour for consumption exceeding 600 KWH during the summer months than other residential customers.

Since Company has been and expects to remain a summer peaking utility for the foreseeable future and has found it necessary to build new generation facilities at higher costs in order to meet the growing peak demand, and the Company's all-electric customers have increased their usage during the summer months at a faster rate than other residential customers, the Commission finds the Company's summer rate design to unreasonably favor all-electric customers.

The Company has never conducted metered load research studies to determine the specific load characteristics of its customers. Company, in conjunction with Ernst & Ernst, has completed a Long Run Incremental Cost Study; however, it did not determine the specific load characteristics of the various customer classes or the percentage of the peak load attributable to the respective customer classes.

The Commission concludes that it is unreasonable for a summer peaking company to provide promotional summer rates for all-electric customers.

The Commission also concludes that it is unreasonable to exempt the winter tail blocks of the space heating tariffs from a rate increase while increasing the tail blocks of other residential and general service customers. In order to insure that the space heating customers share the bur-

den of increasing capital and fixed costs, tariffs should reflect proportionate increases in the winter tail blocks of the space heating customers, the regular residential customers, the general service customers and the commercial and industrial space heating customers.

The Commission concludes that it is unreasonable to eliminate the present provision for water heating since it is obvious that a customer with water heating possesses different usage characteristics than those customers not having water heating.

The Commission concludes that because additional revenues will be provided to Company as a result of the establishment of uniform rates for all residential customers in the summer months and additional revenues by increasing all space heating customers by a porportionate amount, no

increase shall be permitted in the minimum bills of the residential customers.

The Commission therefore concludes that (1) no increase shall be permitted in the minimum bills of the residential customers; (2) Company will maintain the provision for water heating for residential customers, (3) the rates applicable to space heating will be subject to increase, (4) tariff sheet .010 entitled "All Electric Space Heating" shall be retitled "Electric Space Heating" to permit the space heating rate to apply to all customers who use electric space heating, (5) language on tariff sheets which gives choice of customer classification to the customer which permits no change for a period of 12 months will be deleted from all tariff sheets, (6) the additional revenues allowed in this case will be spread in proportion to the operating revenues for the test year

between the residential class of service and all other classes of service, (7) the additional revenues applicable to the residential class of service, after adjustment due to all other rate changes, will be spread on a uniform cents per KWH basis, and (8) the remaining portion of the increase granted in this case will be spread on a uniform cents per kilowatt hour basis to all other classes of service.

b. Gas. Company proposes to increase its present rates on a uniform cents per MCF basis. The Commission concludes that Company's proposed method of increasing rates is reasonable and, therefore, should be employed when designing rates to produce the additional revenues allowed in this case.

6. Depreciation Reserve. Funds invested in the Company are returned to the investors through depreciation expense. The depreciation reserve account consists

of the accumulated depreciation expense and is used to reduce plant in service upon which Company's investors are allowed to earn a return.

In recent years, the Company has sought rate increases approximately every two years, therefore, the rates to be set in this case will undoubtedly be in effect for at least one year.

The number of Company's customers will increase during the year following July 5, 1978, and it is Staff's contention that if the Company's depreciation reserve account at June 30, 1978, is not increased by one-half of its annualized depreciation at that date, its investors will earn a return, in part, on funds which will have come back to them through depreciation expense. The Company is of the opinion that Staff is overstating the electric depreciation reserve by $4,421,442 for electric and

$302,672 for gas. Since Staff's proposal should be adopted, no change in its original cost rate base is proper.

The Commission concludes that Company's investors should earn a return only on that portion of their investment which has not been returned to them through depreciation expense and in the instant case if Company's depreciation reserve account at June 30, 1978, is not increased by one-half of its annualized depreciation expense at that date, its investors will earn a return in part on funds returned to them through depreciation expense.

When a company's KWH sales are expected to increase in future periods it cannot be assumed in the absence of proof that the revenues resulting from the increase in sales will not be sufficient to cover the cost of new plant in service.

7. Materials and Supplies. Staff

proposes to attribute 96 percent of electric materials and supplies and 85 percent of gas materials and supplies to construction work in progress (CWIP) although no particular construction is in progress to which these materials and supplies have been attributed. Section 393.135, V.A.M.S., concerning, CWIP, reads:

> "Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited."

It is the opinion of the Commission that the statute only applies to electric corporations. The 85 percent of the gas materials and supplies attributed to CWIP would, therefore, not be provided for under the terms of this statute. The Commission further finds that the evidence is not

clear and does not support the position that electric materials and supplies can be attributed to CWIP when it appears that a significant portion of the materials and supplies include those which are used in the ordinary maintenance of the Company and not in connection with any significant new construction or expansion.

In light of the fact that the record provides no basis for distinguishing between the two, the Commission concludes that Staff's rate bases have been understated in the amounts of $4,721,312 for electric and $539,922 for gas. The Commission therefore concludes that neither of these amounts should be excluded from the electric and gas rate bases.

8. Compensating Balances. In order to maintain short term lines of credit Company has deposits with several banks which require from 10 percent to 15 percent of the total dollar amount of credit to be

maintained as a compensating balance. Some of the banks with which Company has short term credit lines require additional deposits of 10 percent of any dollar amount actually borrowed by Company.

There is no guarantee that the credit will be available when needed, since either the Company or the banks can terminate the lines of credit at any time. In addition, the conditions of the money market and the Company's financial situation can affect its ability to use the lines of credit. In the past 19 months Company has used its short term lines of credit very briefly only once. Based upon the record, the Commission concludes since Company has maintained lines of credit without using these lines of credit, an increase in electric rate base in the amount of $2,802,343 as proposed by the Company is not proper. The Commission also concludes

that based on competent evidence in the record, Company could finance borrowing less expensively through other methods. The amount of $245,564 will be excluded from the gas rate base.

9. Cash Working Capital and Accruals to Cash Working Capital. A reasonable amount of cash working capital should be added to rate base, since a company engaging in business must have funds to pay for the day-to-day operation of the business until revenues that are earned are actually received. On average, 43 days elapse between the provision of electric or gas utility service by the Company and its receipt of payment for such service. On average, the Company pays electric operation and maintenance expenses approximately 27 days after being incurred, with comparable payments for gas operation and maintenance expenses being made on an average of 33 days after being incurred.

Although the Company's customers presently have ten days to pay their bills before such bills become delinquent, 4 CSR 240-13 will permit those same customers to take 21 days to pay bills before being delinquent. If it is assumed that once 4 CSR 240-13 becomes effective the customers will take on the average 21 days in which to pay their bills, Company will need 27 days worth of cash working capital to cover its electric operation and maintenance expenses and 21 days worth of cash working capital to cover its gas operation and maintenance expenses.

The Staff proposes to reduce the allowance for cash working capital, since accrued franchise taxes, accrued property taxes, and accrued income taxes are customer-supplied funds which the Company can use to cover its cash working capital needs. The Staff also proposed to reduce the allowance for cash working capital with

accrued interest on bonds and the injuries and damages reserve. The Commission does not recognize this adjustment. Taking into account those funds attributed only to accrued franchise taxes, accrued property taxes and accrued income taxes, the Staff's cash working capital in the electric rate base should be increased by $2,235,217 and in the gas rate base by $239,575.

The Commission concludes that a negative cash working capital requirement should be taken as an offset to rate base.

10. Interchange Sales. The Staff has proposed to increase Company's revenues for the test year, under Staff's allocation, in the amount of $1,857,175, less the associated fuel costs of $824,407. The Staff based its total jurisdictional and nonjurisdictional revenues from interchange sales on estimated sales of 261,000 megawatt hours, using a weighted average for the years 1972

through 1976.

The Commission is of the opinion that the Company's estimate of 125,500 megawatt hours is more nearly correct since it is premised upon the potential capacity that would be available for sale each month during the year, a review of the potential buyers from the standpoint that their maintenance programs would, to some extent, determine what they might purchase, and the knowledge of the personal habits of the buying companies and the physical facilities of the Company to engage in interchange sales.

The Commission finds that the adjustment proposed by the Staff is unacceptable and that in fact the five year average used by the Staff, with the first two years in the average being at least doubles and sometimes almost four times as large as the succeeding years, does not recognize the

true picture of interchange sales that the Company is likely to experience during the period of time the rates to be set herein will be in effect.

The Commission concludes that rates should be based as nearly as possible upon normal levels of operation and the use of a weighted average not reasonably calculated to depict a normal level of operations should be rejected.

11. Customer Usage Annualization. The Company's revenues were increased to reflect the number of customers added between December 31, 1977, and June 30, 1978. The Public Counsel has proposed a further adjustment to reflect the Company's experience of a 7.75 percent annual growth in KWH use per customer in the past ten years.

The proposed adjustment does not increase KWH consumption per customer in any

residential class by more than 2.93 percent, and increases KWH consumption per customer for the total Company by 2.8 percent.

Many of Company's expenses were annualized and the Company's rate base was updated for the period ending June 30, 1978.

Since Company's 1977 KWH sales were over ten percent higher than 1976 KWH sales and the proposed usage adjustment does not go beyond the test period and does not create a mismatch for ratemaking purposes, the Commission is of the opinion that Staff's proposed net income for the test year should be adjusted upward by $707,724.

The Commission concludes that an adjustment for increased customer use is reasonable and proper when a company's history demonstrates growth in use per customer and the company's expenses and rate base are

updated to a time in the future since there is a better matching of expenses and rate base with revenues.

13. Fuel Adjustment Clause. The Company used two methods to calculate purchase power fuel costs; one to calculate the purchase power fuel cost to be rolled into the base rates, and the other method to calculate the component of purchase power fuel costs to be considered in the calculation of the monthly fuel adjustment clause.

This calculation caused the customer to receive a larger credit for purchase power fuel cost than the customer has been paying in the base rates.

In calculating the base rate roll-in the Company removed fuel cost associated with nonjurisdictional and interchange sales, but did not remove the KWH sales associated with those costs.

The Company takes the position that it has calculated its fuel adjustment clause in strict conformity with an order of the Commission and as approved by two audits of the Commission. The base amount used by the Company is $.00459 per kilowatt hour. The Staff, on the other hand, has calculated the fuel adjustment clause base at $.00524 per kilowatt hour. As a result, the Company understated its fuel costs per kilowatt hour and included this amount in the fuel adjustment clause of June 1, 1976, thus denying customers full credit for fuel costs in the base rates.

The Commission recognizes that an error in interpretation exists between the Company and the Staff on the computation of the fuel adjustment clause. The Commission is of the opinion that the Staff interpretation is the interpretation which should have been adopted and orders that it

be adopted on the first cost month following the effective date of this order. The result of this difference in interpretation by Company and Staff resulted in an overcharge plus interest in the amount of $366,312. In that the Company has continued to collect on its fuel adjustment clause with the formula as interpreted by the Company rather than Staff, additional revenues have resulted since the Staff computed that amount.

The Commission's decision in Re: Investigation of Fuel Adjustment Clause, Case No. 17,730 (1976), does not provide that the Company is to use two different methods in determining the fuel cost component of purchase power to be used in the roll-in and in the monthly calculation of the fuel adjustment clause.

Additionally, that order does not provide that the Company is to exclude fuel

costs in nonjurisdictional and interchange sales but include those KWH sales in the roll-in and in the monthly calculation of the fuel adjustment clause.

These two mistakes, when netted together, result in the Company over-charging its customers.

The Commission concludes that the Company should come into compliance with Staff's interpretation of the fuel adjustment clause as outlined above, as well as compute any additional overcollection which has occurred since Staff's calculation in the instant case. The total of these revenues should be applied to the costs of the Peabody reclamation. In the event that the costs for the Peabody reclamation are less than the amounts of revenue overcollected, any difference occurring should be credited in an equal amount on a kilowatt hour usage basis to customers' bills.

13. Fuel Expense and Purchased Power. For the year ending October 31, 1976, the Company's percentage of oil generation to the total of oil generation plus purchased power was 1.0386, and for the year ending October 31, 1977, 4.5569, for a difference of percentage increase of 3.5183.

The increase in the Company's percentage of oil generation to the total of oil generation plus purchased power was 3.5183. The sum of 3.5133 and 4.5569 is 8.0752.

During the year ended October 31, 1977, the Company's Sibley 3 unit was down 2,000 hours more than normal, and the Company's Jeffrey unit will come on line by the time that the rates set in this case go into effect.

If a similar percentage increase occurs during the period in which the rates set in this case are in effect, the proper

percentage of oil generation to the sum of oil generation and purchased power is 8.0752. The Staff's calculation appears to be reasonable and no adjustment from the Staff adjusted net operating income is proper.

The Commission concludes, based upon the years ended October 31, 1976, and October 31, 1977, that the Company's percentage of oil generation to the total of oil generation plus purchased power is increasing. It would not be appropriate, therefore, to use in this case the percentage of oil generation to the total of oil generation plus purchased power which obtained during the test year. The Staff's method giving effect to this increasing trend, by adding the percentage increase to the test year level, is reasonable.

A normal level of availability for Sibley 3 and the start-up of Jeffrey 1

will diminish the rate at which the Company's need for oil generation is increasing.

The Company should be permitted to include in this case a level of oil generation which is 8.0752 percent of the total of oil generation plus purchased power.

14. Jeffrey Energy Center - Operation and Maintenance Expenses. The level of Jeffrey operation and maintenance (O&M) expense requested by the Company was an amount extracted from a budget prepared by Kansas Power & Light Company (KPL) which went past the test year in this matter. Since the Company neither presented a witness who participated in the preparation of the budget nor undertook a thorough independent investigation, the Public Counsel seeks exclusion of the amount claimed for O&M on the ground that the

Company has offered no competent witness to support its inclusion.

The Commission concludes that although there is barely sufficient evidence to support the level of operation and maintenance expense which the Company included in its prefiled case, logic compels the conclusion that there will be O&M expense for Jeffrey 1, and the Commission will reluctantly allow the level of O&M expense included in the Company's prefiled case.

15. Sibley Maintenance. The Staff took a four-year simple average on Sibley Unit No. 3 and a three-year simple average on Sibley Units Nos. 1 and 2 to determine a level of maintenance expenses to allow in this rate proceeding.

The Company contended that the entire amount which was spent on the maintenance of Sibley Units Nos. 1, 2 and 3 during the test period should be included in its ex-

penses. As a result, the Company contends that the Staff's maintenance expenses should be increased by $1,325,561.

The evidence adduced at the time of the hearing illustrated that the maintenance expenditures for the Sibley units have tremendously escalated in recent years due to the age of the units, the content of the fuel source (i.e., high-iron coal and high-sulphur coal) and the need to enhance the availability especially of the Sibley No. 3 unit.

Utilization of a simple average method to determine a maintenance expense figure for the Sibley units does not give any credence to the various factors involved in making a correct assessment. The age of the equipment, comparable maintenance expenditures by other utilities, the type of fuel used, the availability of the generating equipment and the general

unavailability of sources at peak periods from which the Company can purchase power, if necessary, must be considered in establishing a proper maintenance expense for these units.

The Commission finds that a three-year weighted average should be employed to determine a proper maintenance level for Sibley No. 3. This is because the weighted average more properly reflects the increasing maintenance trend for Sibley No. 3 while still recognizing that test year expenditures on Sibley No. 3 were abnormal. The three-year average also recognizes that 1974 was an unusual year in Company's history and that expenditures in that year were abnormally low. This results in a normalized maintenance level of $2,244,000 for Sibley No. 3.

To this the Commission would add Staff's three-year average for Sibley

Nos. 1 and 2 of $663,000 (which is greater than Company's actual test year expenditure of $615,000) for a total of $2,907,000.

16. Rate Case Expenses. The Commission finds that an electric rate case expense in the amount of $49,346 and a gas rate case expense in the amount of $5,654 is a reasonable and proper expense. Since the Company seeks rate relief approximately every two years, a two-year amortization for those expenses is reasonable and proper.

The Commission concludes that the denial of rate case expense, even in a questionable case, is equivalent to an attempt to deny management the discretion to seek an increase in revenues when deemed necessary.

17. Tree Trimming Expense. Although the Company recorded as expenses during the test year $545,000 for tree trimming, it actually spent $672,000. The Commission

is of the opinion and finds that the Company's expanding territory will require a greater level of expenditure for tree trimming than experienced prior to the test year and that Company should be allowed to recover its actual tree trimming expense during the test year. The inclusion of the actual amount for tree trimming will, in effect, reduce the Staff's calculated net operating income by $124,047.

The Commission concludes that the recognition of an increasing trend in a particular expense and the inclusion of the currently expended amount will more reasonably reflect the cost to be incurred during the period of time that the rates herein to be set will be in effect.

18. Jeffrey Expense for Training. At the hearing the Staff and Public Counsel agreed to a two-year amortization of the Company's Jeffrey training expense

related to Unit 1 at the Jeffrey Energy Center. Those expenditures were for start-up training attributable to running the new plant. Since those expenses were excluded from the Staff's case, the Commission concludes that it would be proper to reduce the Staff's calculation of net operating income for electric service by an amount of $29,691.

19. Advertising. The Company provides both natural gas and electric service to certain communities in Missouri. In some of those communities, the Company advertisements promote the use of electric heat. If the Company's gas customers convert to electric heat from gas heat, there would be fewer MCF's sold to support the gas system's fixed costs, and if those fixed costs are spread over fewer MCF's, a gas rate increase may be required.

The Commission concludes that it is not

reasonable or proper for the Company's customers to support the Company's attempt to compete against itself. The electric ratepayers should not support an advertising program that may contribute to a gas rate increase, since some of the Company's customers purchase both electricity and natural gas. As a result of this adjustment, the Staff's calculation of electric net operating income should be increased by $1,987.

20. Refunds. The Staff proposed a reduction to Company's rate base for gas of $217,073, which involved refunds at issue received since August 1976. The refunds are paid back by the Company within a twelve month period without interest, as authorized by the Commission in the Company's purchased gas authority tariffs.

The Commission finds the Staff's adjustment should be rejected and that the Com-

pany should be required to continue making refunds through its purchased gas authority tariffs within a twelve month period of time without payment of interest to the customers affected.

The Commission concludes that the amounts of gas refunds paid back to the customer within a twelve month period without interest should not properly be included in rate base.

21. Customer Conservation. The Company has proposed to reduce test period operating revenues to account for anticipated customer conservation. The Company's method to develop such an adjustment is insufficiently sophisticated to measure the full impact of price and weather upon usage, nor does it reveal the rate at which such usage is changing.

The Commission concludes that Company's customer conservation adjustment

shall therefore be disallowed.

22. Additional MCF's. The Staff has proposed to increase the revenues of the Company by $141,155 and to increase the associated gas expenses by $111,994.

The Company has been unable in the past to achieve gas sales based upon the supposed allotment from its pipeline supplier because of monthly restrictions, peak restrictions, peak month restrictions, peak volume restrictions and contract restrictions. Since the Staff's position is largely based upon a letter from the pipeline supplier indicating there might be additional MCF's in the northern service territory, it should be rejected. In addition, the Staff's projected purchases for the period ending December 31, 1978, are beyond the test year. In the Commission's opinion, since the Company's recent history of gas sales is a more accurate indica-

tion of the near future, the Staff's adjustment should be rejected and the proposed increase in net income of $29,161 should not be attributed to the Company.

23. Economic Depreciation. The Company's proposed depreciation rates for its gas plant are based on the assumption that gas supplies will significantly deteriorate in the future, and would increase gas rates from the effective date of the order to be issued in this matter until 1986, after which time gas rates would decline. The rates as proposed would decrease operating income by $401,955. Since the Commission finds that there are insufficient facts upon which to base the assumption relied on by the Company, its position should be rejected.

The Commission concludes that it should not adopt a proposal which must be based on future events that may or may not occur.

24. Easements and Rights of Way (Electric). The Staff and Company have agreed that Company's investments in public rights of way and easements for transmission lines and distribution lines should be amortized over an 84-year period. Public Counsel opposes this agreement. Previously Company has treated rights of way and easements in the same way it has treated land. The Commission finds that rights of way and easements have been recognized for tax purposes by the Internal Revenue Service and supported by case law. Pennsylvania Power & Light Company v. United States, 411 F.2d 1300, and Virginia Electric Power & Light Company v. United States, 411 F.2d 1314.

The Commission concludes that Company may amortize its limited land rights--easements and rights of way--over an 84-year period.

25. Rate Base Additions. The Commission finds that Company was requested to have any additions to rate base in the hands of the Staff on or before the first day of June, 1978, in time for the Staff to audit and certify to the Commission the new levels of plant in service so that the Report and Order could reflect those changes in levels of service well in advance of the Commission's deliberation on the Report and Order.

On this date--Tuesday, June 13--as the order is being completed, the Company has not yet provided Staff with such additions. Nor would the Staff on or after this date have ample opportunity to audit such proposed additions in time for the Commission to issue its Report and Order prior to the operation of law date. While the Commission is aware that it is fixing rates to be in effect in the future, it

is incumbent on the Company to follow the orders of the Commission which are to the mutual advantage of Company, Staff and Commission in setting those rates.

26. Summary. The Commission Staff and Public Counsel agreed that the Company should be allowed to include in rate base an amount of materials and supplies reasonable and necessary for the operation and maintenance of Jeffrey 1, which the Company could verify to the Staff's satisfaction. The Company has not furnished any verification, consequently, there can be no adjustment. It was further agreed that the 90-day coal inventory at Sibley and Jeffrey should be valued at the price of coal to be in effect at the latest possible time the Staff could verify the amount. The Staff has now verified by examination of invoices and other documents that the Company's cost of coal per

ton, in June 1978, is $17.414 at Sibley. At Jeffrey the current price of coal is $9.952 in addition to the cost of leasing freight cars, which has already been allowed in the Staff's case. The resultant proper increase in rate base thereby becomes $1,028,721.

As a result of all of the foregoing adjustments, the Commission finds that the amount of the investor-contributed net original cost rate base for electric service is $207,999,611. Taking into consideration all of the adjustments herein found to be reasonable, the net original cost of the Company's investor-contributed gas rate base is $12,676,672.

During the course of the hearing, the Commission Staff acknowledged the correctness of recalculating line loss factor, an increase in purchased power expense, and income tax expense. Those recalculations

result in an increase in net operating income of approximately $6,000. Taking into consideration all of the foregoing adjustments, including an adjustment for income tax, the net operating income resulting from electric operations is $18,308,669. The corresponding net operating income for gas operations on an annual basis, as a result of all proper adjustments, is $936,666.

The Company's rate of return on its net original cost electric rate base is 8.802 percent and based on the capital structure herein found applicable, the rate of return on the common equity portion of the electric rate base is 11.90 percent. Those rates of return are below those found herein to be fair and reasonable.

The rate of return on Company's net original cost rate base for gas is 7.389 percent with the return on common equity

being 7.20 percent, also below that found herein to be fair and reasonable. The Commission finds the fair value of Company's electric properties to be $310,085,352 and the rate of return thereon 5.90 percent. The fair value of Company's gas properties is found to be $25,633,927 and under the present level of operations the rate of return thereon is 3.65 percent.

The Commission finds that Company's present level of operations results in a revenue deficiency for electric service in the amount of $976,980 and a revenue deficiency for gas service in the amount of $421,154.

Finally, the Commission concludes that the Applicant is a public utility subject to the jurisdiction of this Commission pursuant to Chapters 386 and 393, RSMo 1969.

The tariffs which are the subject matter of this proceeding are suspended pur-

suant to authority vested in this Commission by virtue of Section 393.150, RSMo 1969.

The Commission, after notice and hearing, may order a change in any rate, charge or rental, and it may determine and prescribe the lawful rate, charge or rental and the lawful regulation or practice affecting said rate, charge, or rental thereafter to be observed.

The burden of proof to show that the increased rate or the proposed increased rate is just and reasonably shall be upon the company.

In determining just and reasonable rates and charges for the company to observe, the Commission may consider all facts which, in its judgment, have any bearing upon a proper determination of the price to be charged with due regard, among other things, to a reasonable return

upon the value of the property actually used in the public service, and to the necessity of making reservations out of income for surplus and contingencies.

The Commission is of the opinion that in setting just and reasonable rates, in addition to following the requirements of Section 393.270, RSMo 1969, it must also consider the "fair value" of the property of the applicant in its proper relationship to all other facts that have a material bearing on the establishment of "fair and just" rates. State ex rel. Missouri Water Company v. Public Service Commission, 308 S.W.2d 704 (Mo. 1958).

When the Commission finds that the company's level of operations results in a rate of return exceeding that found to be fair and reasonable, the proposed tariffs which would result in an increase in rates should be disallowed and the company should

be ordered to file new tariffs reducing its rates to a level consistent with the rate of return on the value of its property found to be reasonable.

When the company's level of operations does not permit a recovery of earnings in an amount found to be fair and reasonable, the company should be allowed to file tariffs for increased rates.

The Commission concludes that Company's Late-filed Exhibit No. 50 should be received in evidence for the limited purpose of establishing the most recent cost of coal available pursuant to the agreement at the hearing, but not for the purpose of establishing price of other forms of energy not the subject of an agreement between the parties at the hearing.

It is, therefore,

ORDERED: 1. That the proposed revised electric tariffs filed by Missouri

Public Service Company in Case No. ER-78-29 are hereby disapproved and the Company is authorized to file in lieu thereof, for approval by this Commission, tariffs designed to increase gross revenues by approximately $976,980, exclusive of gross receipts and franchise taxes.

ORDERED: 2. That the proposed revised gas tariffs filed by Missouri Public Service Company in Case No. GR-78-30 are hereby disapproved and the Company is authorized to file in lieu thereof, for approval by this Commission, tariffs designed to increase gross revenues by approximately $421,154, exclusive of gross receipts and franchise taxes.

ORDERED: 3. That the Missouri Public Service Company shall file its tariffs in compliance with this Report and Order on or before June 27, 1978, using the rate design as set out in this

Report and Order.

ORDERED: 4. That the rates established in the tariffs may become effective for service rendered on and after the 5th day of July, 1978.

ORDERED: 5. That this Report and Order shall become effective on the 5th day of July, 1978.

BY THE COMMISSION

R. Michael Jenkins
Secretary

(SEAL)

Fraas, Chm., McCartney and
Slavin, CC., Concur and
certify compliance with the
provisions of Section 536.080,
RSMo 1969.
Sprague and Jones, CC., Dissent
with separate opinions.

Dated at Jefferson City, Missouri,
on this 23rd day of June, 1978.

APPENDIX F

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a Session of the Public Service Commission held at its office in Jefferson City on the 12th day of July, 1978.

CASE NO. ER-78-29

In the matter of Missouri Public Service Company of Kansas City, Missouri, for authority to file tariffs reflecting increased rates for electric service to its customers in the Missouri service area of the company.

CASE NO. GR-78-30

In the matter of Missouri Public Service Company of Kansas City, Missouri, for authority to file tariffs reflecting increased rates for gas service to its customers in the Missouri service area of the company.

ORDER DENYING APPLICATION FOR REHEARING

The Commission issued its Report and Order herein on June 23, 1978, to become effective July 5, 1978.

On July 3, 1978, Missouri Public Service Company filed its Application For Rehearing

wherein it alleges numerous errors in the Report and Order.

The Commission upon consideration of the Application For Rehearing is of the opinion that it should be denied.

It is, therefore,

ORDERED: 1. That the Application For Rehearing filed herein on July 3, 1978, by Missouri Public Service Company be, and the same is, hereby denied.

ORDERED: 2. That this order shall become effective on the date hereof.

BY THE COMMISSION

R. Michael Jenkins
Secretary

Fraas, Chm., McCartney, and
Slavin, CC., Concur and certify
compliance with the provisions of
Section 536.080, RSMo 1969.
Sprague, C., Dissents.
Jones, C., Absent.

Appendix

2

81-468

NO. 31537

LODGING

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IN THE

MISSOURI COURT OF APPEALS

WESTERN DISTRICT

STATE OF MISSOURI, ex rel. MISSOURI PUBLIC SERVICE COMPANY, a Missouri corporation,

Relator-Appellant-Respondent,

vs.

PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI,

Respondent-Appellant.

Appeal From the Circuit Court of Cole County, Missouri, Nineteenth Judicial Circuit, Honorable Byron L. Kinder, Judge

RESPONDENT'S BRIEF AND REPLY BRIEF OF RELATOR-APPELLANT-RESPONDENT, MISSOURI PUBLIC SERVICE COMPANY

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IN THE MISSOURI COURT OF APPEALS

WESTERN DISTRICT

STATE OF MISSOURI, ex rel. MISSOURI PUBLIC SERVICE COMPANY, a Missouri corporation,	)	
Relator-Appellant-Respondent,	)	
vs.	)	WD No. 31537
PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI,	)	
Respondent-Appellant.	)	

RESPONDENT'S BRIEF AND REPLY BRIEF OF
RELATOR-APPELLANT-RESPONDENT,
MISSOURI PUBLIC SERVICE COMPANY

Jurisdictional Statement

On August 4, 1977, Missouri Public Service Company (hereinafter "Company") submitted its revised electric and gas rate schedules to the Missouri Public Service Commission (hereinafter "Commission") (L.F. 12).[1] The revised schedules would have allowed Company to increase its gross annual revenues from electric and gas service by approximately $18,723,097 and $2,167,137, respectively (exclusive of applicable gross receipts and franchise taxes) (L.F. 12-13). By orders dated August 15, 1977, and September 13, 1977, the Commission suspended the effective date of those revised electric rate schedules until July 4, 1978 (L.F. 13).

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[1]References to the transcript on appeal are designated "T," which indicates the hearing transcript before the Missouri Public Service Commission, and "L.F." indicates the legal file before this Court.

After fully contested evidentiary hearings in which the Company, Commission Staff (hereinafter "Staff"), the Office of Public Counsel (hereinafter "Public Counsel"), the City of Kansas City and Jackson County, Missouri, participated (L.F. 13-14), the Commission issued its report and order on June 23, 1978, to become effective July 5, 1978. In this order, the Commission denied, in great part, the request of Company to increase its rates and charges for electric and gas services provided to its Missouri customers (L.F. 31). More specifically, of the proposed increase in gross annual revenues of $18,723,097 for electric service and $2,167,137 for gas service, the Commission authorized Company to increase its rates and charges for electric and gas service to its Missouri customers so as to produce additional gross revenues, exclusive of gross receipts and franchise taxes, only in the amount of $976,980 for electric service and $421,154 for gas service (L.F. 31).

On July 3, 1978, Company filed an application for rehearing before the Commission, seeking a rehearing of both the electric and gas rate cases (L.F. 10, 51-68). The Commission issued its order denying Company's application for rehearing on July 12, 1978 (L.F. 10, 69).

On June 29, 1978, the Commission issued a correction order, effective July 5, 1978 (L.F. 10, 50). That correction order does not affect any matter relevant to Company's responding brief.

On July 12, 1978, Company filed its petition for writ of certiorari or review (L.F. 8-70). On that same date, the Honorable Byron L. Kinder, Judge of the Circuit Court of Cole County, Missouri, granted Company's petition and issued a writ of review (L.F. 71).

On December 19, 1979, the Circuit Court of Cole County, Missouri,

by its findings, conclusions and judgment, reversed the Commission's report and order in Cases No. ER-78-29 and GR-78-30, and remanded the same to the Commission (L.F. 153-160). Both Company and the Commission filed timely notices of appeal from that judgment of the Circuit Court of Cole County, Missouri (L.F. 161-171).

The Commission's appeal, to which Company is responding, involves the lawfulness and reasonableness of the decision by the Circuit Court of Cole County to reverse and remand that portion of the Commission's report and order concerning cost of money/rate of return, customer usage annualization, depreciation reserve and a fuel adjustment clause offset. Therefore, the lawfulness and reasonableness of the Commission's report and order concerned with those issues are also before this Court.

Since the Commission, by leave, filed one brief as both appellant and respondent, Company responds herein for the most part, but also replies briefly in the latter part of this brief.

This appeal is authorized by §386.540, RSMo 1978. It does not involve a construction of the Constitution of the United States, or the State of Missouri, the validity of a treaty or statute of the United States, or any authority exercised thereunder, construction of the revenue laws of the State of Missouri, title to any office of the State of Missouri, nor is it an appeal from an offense punishable by life imprisonment. Therefore, this appeal is within the general appellate jurisdiction of the Missouri Court of Appeals. Mo. Const. art. V, §3 (1945, as amended, 1970, 1976). Territorial jurisdiction is vested in the Western District of said Court by §447.070, RSMo 1978.

Statement of Facts

The "Statement of Facts" contained in the appellant portion of the Commission's brief concerning the issue of cost of money/rate of return, including attrition, is both argumentative and unfair and, thereby, violates Rule 84.04(c) (see e.g. Commission Brief, at 6, 8). Furthermore, said statement is so inadequate that Company could not cure the same and, therefore, offers the following as its "Statement of Facts" pertaining to the issue of cost of money/rate of return.

The evidence relative to cost of money/rate of return concerns the following: (1) the proper adjustments to the target market/book value to account for preoffering pressure and issuance expenses; (2) the appropriateness of a mechanical mathematical model to be used, without independent judgment, to determine Company's required rate of return; (3) the consideration of Company's stock dividend policy; (4) the consideration of Company's lower-than-average equity ratio and its correspondingly higher-than-average risk factor; and (5) the use of an attrition factor. Each of these issues is thoroughly discussed in the text of Company's argument. The following is offered as a fair and concise summary of the facts relevant to each of those issues.

Adjustments to Target Market/Book Value

Two methods for reaching a required return on equity were used in this rate proceeding: Company utilized a discounted cash flow (DCF) analysis (T 372-390), while Staff's witness developed a regression model (T 460-501). An appropriate target market/book value is required before either analysis will yield an accurate required rate of return.

There are two recognized independent variables that determine market/book price--flotation costs and preoffering pressure (T 2523-2524). Flotation costs are those expenses directly associated with the new issuance of common stock. This includes brokers' fees, attorneys' fees, printing expenses, etc. Preoffering pressure is a phenomenon that occurs in the market when there is an existing supply of a commodity, such as common stock, and that supply is increased by a new offering, without a corresponding increase in obvious buyers. When the supply increases, yet the demand does not increase, the price of the commodity is expected to drop.

Both Staff and Company witnesses acknowledge the existence of preoffering pressure (T 2296, 2523, 2702-2705; Company Exhibit 37). Staff witness Burkhardt conceded that in the past, when using a discounted cash flow (DCF) analysis, he used a "lump ten percent" margin that was added to the market price to compensate for both preoffering pressure and flotation cost (T 2295, 2297). Company witness Baker demonstrated in Company Exhibit 37 that during Company's last preoffering period, that period between the date of the announcement of the offering and the date of the actual offering, the market price of Company's stock declined 8.70 percent, as compared with the decline of 1.51 percent in the Standard & Poor's Utility Index. This differential in excess of 7 percent is quantifiable preoffering pressure for Company' common stock. Company witness, Dr. Eugene F. Brigham, stated that "market pressure does exist" (T 2523), and that preoffering pressure and flotation costs must be incorporated into the target market/book price (T 2523-2524).

The following summarizes Staff's evidence with respect to preoffering pressure: (1) Staff witness Burkhardt recommended a target market/

book value of 106 percent book price (T 473); (2) Staff witness Burkhardt recognized the existence of preoffering pressure (T 2296); (3) Staff witness Burkhardt did not make any study to determine the existence of, or quantify the amount of, preoffering pressure with respect to Company's prior stock issuances (T 2297); and (4) Staff witness Burkhardt's recommendation of a target market/book price of 106 percent of book value did not include any allowance for preoffering pressure (T 2295).

Use of a Mechanical Mathematical Model to Determine Company's Required Rate of Return Rejecting Company's Stock Dividend Policy and the Effect of Company's Low Equity Ratio

As previously stated, two methods for determining Company's required rate of return were utilized in this proceeding. The method used by Company was a discounted cash flow (DCF) analysis (T 359-390). Staff utilized a multiple regression model (T 460-501). The facts relevant to both of these methods are thoroughly discussed in Point III, infra. Consequently, a detailed factual discussion of the same will not be presented in this portion of Company's brief. However, Company provides the following summary of those facts.

Staff witness Burkhardt employed a multiple regression model developed from 95 utility companies identified in his Schedule 16 (T 485). Company was not included in that Schedule 16. The model attempts to measure what investors are willing to pay against what they receive (T 482).

Mr. Burkhardt selected twelve listed variables (T 483-484) and used data for calendar year 1976 respecting the 95 companies (T 481, 2342-2344). The results of Mr. Burkhardt's model led him to believe that only the following six variables were statistically significant

(T 485): (1) book yield; (2) earnings' gross; (3) bond rating; (4) regulatory ranking; (5) stock exchange listing; and (6) cash coverage of dividends.

This was the third major rate case in less than twelve months in which a multiple regression model was used by Staff witness Burkhardt (T 2307-2308). Consequently, Company developed extensive testimony during cross-examination of Mr. Burkhardt with respect to the numerous inconsistencies with the use and results of the model utilized in this case and the models used in Re: Union Electric Company, Case No. ER-77-154 (Mo. P.S.C. 1978) and Re: Kansas City Power & Light Company, Case No. ER-77-118 (Mo. P.S.C. 1977) (T 2307-2315).

Mr. Burkhardt admitted that his model makes use of ordinary least squares in such a manner as to produce an equation that tends to develop coefficients which are representative of average companies (T 2332). In other words, the model was designed to be a reliable predictor of the individual variables which determine the market to book ratio of companies similar to the average company included in the model. That being the case, Company developed evidence with respect to the significant differences between the characteristics of the companies used in the model and the characteristics of Company (T 377-379, 2322-2393). In that the model consisted of 95 of the 110 regulated electric utilities, Company used the industry averages proffered by witness Burkhardt for this analysis (Staff Exhibit 2).

Company has, from 1957 to date, paid a stock dividend (Staff Exhibit 2, Appendix at 10). However, neither Company nor any other company utilizing a stock dividend was included in the model (T 2308-2309). When asked why Rochester Gas and Electric Company was excluded

from his model, Mr. Burkhardt stated that the reason for excluding it was because it paid a stock dividend like Company (T 2308). This is the same reason why he excluded Company from the model (T 2333). Mr. Burkhardt conceded both were excluded because it was simply too difficult for him to measure the value of the stock dividend paid by Company and Rochester Gas and Electric (T 2333). Mr. Burkhardt's analysis concluded that bond rating was a significant variable in determining the appropriate market/book value (T 490). However, when computing Company's required market/book value, he used an assumed AA bond rating (T 2322). Company's bonds are unrated (T 2322). When asked why he did not use Company's no bond rating, Mr. Burkhardt replied that when you plug Company's no bond rating into his model, the "model . . . goes to pot" (T 2328).

Company's average cash payout ratio for the years 1967 to 1976 was 50.7 percent compared with the industry average of 68.9 percent (Staff Exhibit 2, Schedule 18). Mr. Burkhardt's recommended rate of return was based on an assumed payout ratio of 67.5 percent for Company, as opposed to its actual ratio of 42.7 percent for 1976 (T 2347; Staff Exhibit 2, Schedule 17).

Other variables which distinguish Company from the average company in the model are its high percentage of residential customers, low industrial base, and its correspondingly low load factor (T 2335-2336). Such a low load factor creates more difficulty in recouping fixed costs; consequently, such makes investment in Company riskier than investment in a company with a high load factor. Nevertheless, this characteristic was not considered by Mr. Burkhardt (T 2335-2336).

Company has a lower-than-average equity ratio (T 2339-2340). Staff witness Burkhardt concluded that this lower-than-average equity ratio, accompanied by a higher-than-average risk factor, is not important in setting a return on equity (T 2339, 2386). Although Mr. Burkhardt stated that investors believed that an electric company is an electric company and that they do not require a higher return for investing in a relatively riskier electric company (T 493), on cross-examination, he conceded that if he were to choose between two companies being equal in all respects except that one was characterized by a higher risk and the other was characterized by a lower risk, he would invest in the latter (T 2386-2389).

Mr. Burkhardt concluded by stating that Company's problem was its stock dividend policy and low payout ratio (T 495). Recall that Company's stock dividend policy was not tested by the Burkhardt model to determine its significance and that the Burkhardt model found payout ratio to be insignificant (T 483-485, 2339, 2386).

After recommending a range with a midpoint of 12.71 percent return on equity based on assumed earnings per share of $1.96, coupled with an assumed 67.5 percent cash payout ratio (T 2347), Mr. Burkhardt was asked to consider Company's financial condition and explain how the Company could possibly achieve those results. Mr. Burkhardt, quite frankly, admitted that he could not tell Company how it could do so (T 2366).

Company employed Eugene F. Brigham, Professor of Finance at the University of Florida, and Director of the Public Utility Research Center at that institution. Dr. Brigham's broad experience, in both the public and private sectors, is indisputable (T 2471-2478).

After reviewing Staff's regression model, Dr. Brigham recognized the concept as being based upon the work of Professor Myron Gordon (T 2512); however, he criticized Staff's application of the model in three principal areas, as well as some other related areas. The three principal areas of criticism involved the use of 1976 data rather than more recent information, the handling of Company's stock dividend and the treatment of Company's equity ratio (T 2479). The details of Dr. Brigham's criticism are contained in Point III, infra. Suffice it to say, at this point, that Dr. Brigham extensively disagreed with the use and results of the model utilized by Staff witness Burkhardt. Dr. Brigham summarized the errors in Staff's regression model by stating that the model actually gathers all of the errors and concentrates them all in one variable (T 2503). In other words, Mr. Burkhardt assumed that all of these coefficents were exactly right and then forced everything else into the book yield term, thus yielding a distorted value (T 2503).

Company witness John R. Baker utilized a discounted cash flow (DCF) analysis to derive Company's required rate of return. The results of Mr. Baker's analysis led him to believe that Company's required rate of return was 15.2 percent (T 383). Mr. Baker also defended Company's stock dividend policy by relating the results of a survey taken by Company in March, 1978, wherein approximately 90 percent of the shareholders surveyed approved of Company's current stock dividend policy (T 2173). Furthermore, Mr. Baker's DCF analysis utilized a value of 4 percent on Company's stock dividend (T 382-384).

The only witness from the financial community to testify with respect to Company's stock dividend policy was Robert H. Hanson (T

2676-2700). Mr. Hanson is a Vice President of Merrill Lynch Pierce Fenner & Smith, Inc., and is a member of the public utility department of that firm's investment division (T 2679). Mr. Hanson indicated that Company's stock dividend policy had served it and its customers very well over the years (T 2683). Mr. Hanson disagreed with Mr. Burkhardt's conslusion that investors do not assign substantial value to Company's stock dividend policy (T 2684). Mr. Hanson noted the tax advantages (T 2686), the favorable impact on internally generated cash (T 2687), and the contribution to the common equity component of Company's capital structure (T 2687) that had resulted from Company's stock dividend policy. Mr. Hanson was not cross-examined by the Staff's attorney, and when questioned by a Commissioner, Mr. Hanson indicated that he would certainly recommend a continuance by Company of its stock dividend policy (T 2697-2698).

Dr. Brigham and Dr. David A. West, Professor of Finance at the University of Missouri-Columbia, both testified with respect to the impact resulting from Company's low equity ratio. Dr. Brigham stated that the subject has been extensively studied, and everyone, barring Staff witness Burkhardt, has reached a conclusion that a lower equity ratio requires a higher return on equity to compensate the investor for investing in a riskier company (T 2516-2517). Dr. West stated that, contrary to Mr. Burkhardt's conclusion, Company's customers have indeed benefitted from Company's low equity ratio policy (T 2669-2672). Dr. West indicated that Company's capital structure "permits a lower total cost of capital" than would be the case with a higher equity ratio and, as a result, Company's "customers have enjoyed a substantial savings

over the past decade" (T 2669). Dr. West was not cross-examined by Staff's attorney, and there were no questions on cross-examination by any party with respect to the substance of his testimony.

Allowance for Attrition

Staff and Company offered uncontradicted evidence that attrition has occurred with respect to the previous rates of return authorized by the Commission for this Company (T 388-389; Company Exhibit 1, Section 7, Schedule 2; T 496-497; Staff Exhibit 2, Schedules 21, 22). Staff witness Burkhardt pointed out the following five principal factors that contribute to attrition: (1) declines in kilowatt-hour sales growth; (2) new plant additions; (3) inflation; (4) increases in fixed capital costs; and (5) operational difficulties with generating plant (T 497-498). Of these five factors, the witness indicated that declines in kilowatt-hour sales growth is the most significant determinant of attrition for many electric companies (T 498). He further indicated that he saw no indication that these factors would not continue in the future (T 498-499). Furthermore, the Staff witness stated that his model for determining the rate of return only considered the additional cost related to new fixed charges on capital (T 499). Consequently, his model would not account for attrition resulting from the other four factors.

Both Staff and Company witnesses recommended an attrition allowance (T 387-389; Company Exhibit 1, Section 7, Schedule 6; T 499). Staff's witness recommended that the Commission specifically set forth the approved attrition allowance if, during the past years, as both Company and Staff exhibits demonstrated, Company has been unable to

earn the return authorized by the Commission (T 499).

Company's witness testified that over the past five years, Company has suffered on the average a 20 percent shortfall of the authorized return because of attrition (T 388; Company Exhibit 1, Section 7, Schedule 2). Consequently, he recommended a modest attrition allowance of .28 percent be added to the rate of return on original cost net rate base (T 387-389; Company Exhibit 1, Section 7, Schedule 6).

The report and order of the Commission said nothing about attrition.

Points Relied On

I.

THE CIRCUIT COURT DID NOT ERR IN HEARING AND RULING UPON THE ISSUES RAISED BY COMPANY'S APPEAL, BECAUSE COMPANY'S APPEAL WAS NOT AND IS NOT MOOT IN THAT THE COMPANY COULD RECEIVE PRACTICAL RELIEF FROM A JUDICIAL DETERMINATION OF THE ISSUES INVOLVED AND EVEN IF THE COURT FINDS THESE ISSUES TO BE MOOT, THE ISSUES RAISED BY COMPANY PRESENT MATTERS OF SUBSTANTIAL PUBLIC INTEREST WHICH REQUIRE JUDICIAL DETERMINATION FOR FUTURE GUIDANCE OF PUBLIC OFFICERS.

Southern Pacific Terminal Company vs. Interstate Commerce Commission, 219 U.S. 498, 31 S.Ct. 279 (1911).

United States vs. Trans-Missouri Freight Association, 166 U.S. 290, 17 S.Ct. 540 (1897).

Roe vs. Wade, 410 U.S. 113, 93 S.Ct. 705 (1973).

§§393.090, 393.150, 393.270, RSMo 1978.

Intermountain Gas Co. vs. Idaho Public Utilities Commission, 98 Idaho 718, 571 P.2d 1119 (1977).

Board of Gas and Electric Commissioners of Middleborough vs. Department of Public Utilities, 363 Mass. 433, 294 N.E.2d 866 (1973).

General Telephone of Michigan vs. Public Service Commission, 341 Mich. 620, 67 N.W.2d 882 (1954).

Michigan Bell Telephone Co. vs. Public Service Commission, 315 Mich. 533, 24 N.W.2d 200 (1946).

Michigan Bell Telephone Co. vs. Public Service Commission, 85 Mich. App. 163, 270 N.W.2d 546 (1978).

General Telephone Company of Michigan vs. Michigan Public Service Commission, 78 Mich. App. 528, 260 N.W.2d 874 (1977).

State ex rel. Utility Consumers Council of Missouri, Inc. vs. Public Service Commission, 585 S.W.2d 41 (Mo. en banc 1979).

State ex rel. Donnell vs. Searcy, 347 Mo. 1052, 152 S.W.2d 8 (en banc 1941).

State ex rel. Laclede Gas Company vs. Public Service Commission, 600 S.W.2d 222 (Mo. App., W.D. 1980).

State ex rel. Dyer vs. Union Electric Company, 312 S.W.2d 151 155 (Mo. App., D. St. L. 1958).

Western Auto Supply Co. vs. Banner, 288 S.W.2d 402 (Mo. App., D. St. L. 1956).

Morrison vs. State, 252 S.W.2d 97 (Mo. App., D.K.C. 1952).

Milwaukee & Suburban Transport Corp. vs. Public Service Commission, 268 Wis. 573, 68 N.W.2d 552 (1955).

II.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE IS NOT SUPPORTED BY ADEQUATE FINDINGS OF FACT AND CONCLUSIONS OF LAW AS REQUIRED BY §536.090, RSMO 1978, IN THAT SAID FINDINGS AND CONCLUSIONS FAIL TO DISCLOSE:

(A) WHAT METHOD WAS USED TO DETERMINE COMPANY'S ALLOWED RETURN ON EQUITY, A MAJOR ISSUE IN THE CASE;

(B) ANY REFERENCE TO AN ATTRITION ALLOWANCE, A MAJOR ISSUE IN THE CASE;

(C) WHETHER ANY ALLOWANCE FOR PREOFFERING PRESSURE WAS MADE, ANOTHER ISSUE IN THE CASE; AND

(D) WHETHER THE COMMISSION CONSIDERED INCREASED FLOTATION COSTS, ANOTHER ISSUE IN THE CASE.

St. Louis County vs. State Tax Commission, 515 S.W.2d 446 (Mo. 1974).

Stephen & Stephen Properties, Inc. vs. State Tax Commission, 499 S.W.2d 798 (Mo. 1973).

Glasnapp vs. State Banking Board, 545 S.W.2d 382 (Mo. App., D.K.C. 1976).

§536.090, RSMo 1978.

Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944).

Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 43 S.Ct. 675 (1923).

State ex rel. Martigney Creek Sewer Co. vs. Public Service Commission, 537 S.W.2d 388 (Mo. en banc 1976).

Iron County vs. State Tax Commission, 480 S.W.2d 65 (Mo. 1972).

State ex rel. Hotel Continental vs. Burton, 334 S.W.2d 75 (Mo. 1960).

State ex rel. Missouri Water Company vs. Public Service Commission, 308 S.W.2d 704 (Mo. 1957).

State ex rel. St. Louis Public Service Co. vs. Public Service Commission, 291 S.W.2d 95 (Mo. en banc 1956).

State ex rel. Capital City Water Company vs. Public Service Commission of Missouri, 252 S.W. 446 (Mo. en banc 1922).

Century State Bank vs. State Banking Board of Missouri, 523 S.W.2d 856 (Mo. App., D.K.C. 1975).

III.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE UNLAWFULLY RESULTS IN CONFISCATION OF COMPANY'S PROPERTY BY TAKING ITS PROPERTY FOR PUBLIC USE WITHOUT JUST COMPENSATION, IN THAT THE COMMISSION:

(A) FAILED TO ADJUST THE TARGET MARKET/BOOK VALUE FOR PREOFFERING PRESSURE;

(B) IGNORED RELEVANT AND SIGNIFICANT SHORTCOMINGS INHERENT IN THE METHODOLOGY USED BY THE STAFF IN DETERMINING COMPANY'S RETURN ON EQUITY (ASSUMING AND SPECULATING THAT THE STAFF'S METHODOLOGY WAS RELIED UPON, ALTHOUGH THE REPORT AND ORDER IS SILENT ON THE MATTER); AND

(C) FAILED TO INCLUDE AN ATTRITION FACTOR IN COMPUTING COMPANY'S REQUIRED RATE OF RETURN;

ALL RESULTING IN RATES THAT DO NOT PROVIDE COMPANY WITH AN OPPORTUNITY TO EARN A JUST AND REASONABLE RETURN ON THE VALUE OF ITS PROPERTY USED IN THE PUBLIC SERVICE.

Generally

Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 43 S.Ct. 675 (1923).

Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 43 S.Ct. 544 (1923).

State ex rel. Missouri Water Company vs. Public Service Commission, 308 S.W.2d 704 (Mo. 1957).

U.S. Const. amend. V, XIV.

Mo. Const. art. I, §26.

§§393.150, 393.270, RSMo 1978.

Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944).

Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 151, 54 S.Ct. 658 (1934).

Smith vs. Illinois Bell Telephone Co., 282 U.S. 133, 51 S.Ct. 65 (1930).

United Rys. & Electric Co. of Baltimore vs. West, 280 U.S. 234, 50 S.Ct. 123 (1930).

III.A.

Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 43 S.Ct. 675 (1923).

Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 43 S.Ct. 544 (1923).

III.B.

Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 43 S.Ct. 544 (1923).

Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944).

Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 151, 54 S.Ct. 658 (1934).

Re: Boston Edison Company, 30 PUR 4th 477 (F.E.R.C. 1979).

Re: Union Electric Company, Case No. ER-77-154 (Mo. P.S.C. 1978).

Re: Kansas City Power & Light Company, Case No. ER-77-118 (Mo. P.S.C. 1977).

III.C.

West Ohio Gas Co. vs. Public Utilities Commission of Ohio, 294 U.S. 79, 55 S.Ct. 324 (1935).

Smith vs. Illinois Bell Telephone Co., 282 U.S. 133, 51 S.Ct. 65 (1930).

Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 151, 54 S.Ct. 658 (1934).

Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 43 S.Ct. 675 (1923).

Re: General Telephone Company of Florida, 19 PUR 4th 227 (Fla. P.S.C. 1977).

New York Telephone Co. vs. Public Service Commission, 29 N.Y. 2d 164, 272 N.E.2d 554 (1971).

Re: Brooklyn Union Gas Company, 17 PUR 4th 451 (N.Y. P.S.C. 1976).

Narragansett Electric Company vs. Harsch, 117 R.I. 395, 368 A.2d 1194, 20 PUR 4th 112 (1977).

South Central Bell Telephone Company vs. Tennessee Public Service Commission, 579 S.W.2d 429, 31 PUR 4th 172 (Tenn. App. 1979).

Re: Wisconsin Michigan Power Company, 15 PUR 4th 488 (Wis. P.S.C. 1976).

IV.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE IS UNREASONABLE IN THAT SUCH FINDINGS AS WERE MADE BY THE COMMISSION ARE NOT SUPPORTED BY ~~COMPETENT AND SUBSTANTIAL~~ EVIDENCE UPON THE WHOLE RECORD IN THAT:

(A) THE COMMISSION DID NOT CONSIDER PREOFFERING PRESSURE IN ESTABLISHING THE TARGET MARKET/BOOK VALUE;

(B) THE COMMISSION MAY HAVE RELIED (ALTHOUGH IT DOES NOT SO STATE) UPON A MECHANICAL STATISTICAL MODEL THAT WAS DEFECTIVE IN SEVERAL RESPECTS.

(C) THE COMMISSION DID NOT MAKE AN ALLOWANCE FOR ATTRITION.

State ex rel. Utility Consumers Council of Missouri, Inc. vs. Public Service Commission, 585 S.W.2d 41 (Mo. en banc 1979).

State ex rel. Kansas City Transit, Inc. vs. Public Service Commission, 406 S.W.2d 5 (Mo. en banc 1966).

State ex rel. Ozark Electric Cooperative vs. Public Service Commission, 527 S.W.2d 390 (Mo. App., D.K.C. 1975).

Mo. Const. art. V, §18.

§386.510, RSMo 1978.

Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 151, 54 S.Ct. 658 (1934).

V.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER IN THAT:

(A) THE COMMISSION ERRONEOUSLY AUTHORIZED A CUSTOMER USAGE ANNUALIZATION BASED UPON MISMATCHED EXPENSES COMPUTED ON AN OCTOBER 31, 1977 YEAR-END BASIS WITH REVENUES COMPUTED ON A JUNE 30, 1978 YEAR-END BASIS; AND

(B) THE COMMISSION DECREASED COMPANY'S DEPRECIATION RESERVE BASED ON A RESERVE FIGURE AT DECEMBER 31, 1978, THAT WAS MISMATCHED WITH A PLANT FIGURE FOR JUNE 30, 1978, THEREBY ERRONEOUSLY ASSUMING CONSTANT PLANT IN SERVICE FOR COMPANY.

V.A.

Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 43 S.Ct. 544 (1923).

V.B.

Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944).

Sam vs. St. Louis & M.R. Co., 174 Mo. 53, 73 S.W. 686 (1903).

Re: Kansas City Power & Light Company, Case No. ER-77-118 (Mo. P.S.C. 1978).

VI.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE FUEL ADJUSTMENT CLAUSE ISSUE BECAUSE THAT PORTION OF THE REPORT AND ORDER IS UNLAWFUL IN THAT THE COMMISSION'S OFFSET AGAINST FUTURE REVENUE REQUIREMENTS BASED ON THE ERRONEOUS ASSUMPTION THAT COMPANY HAD RECEIVED OVER-COLLECTIONS THROUGH THE USE OF THE FUEL ADJUSTMENT CLAUSE CONSTITUTES CONFISCATION OF COMPANY'S PROPERTY THROUGH RETROACTIVE RATEMAKING.

Board of Public Utility Com'rs vs. New York Telephone Co., 271 U.S. 23, 46 S.Ct. 363 (1926).

State ex rel. Utility Consumers Council of Missouri, Inc. vs. Public Service Commission, 585 S.W.2d 41 (Mo. en banc 1979).

Argument

I.

THE CIRCUIT COURT DID NOT ERR IN HEARING AND RULING UPON THE ISSUES RAISED BY COMPANY'S APPEAL, BECAUSE COMPANY'S APPEAL WAS NOT AND IS NOT MOOT IN THAT THE COMPANY COULD RECEIVE PRACTICAL RELIEF FROM A JUDICIAL DETERMINATION OF THE ISSUES INVOLVED, AND EVEN IF THE COURT FINDS THESE ISSUES TO BE MOOT, THE ISSUES RAISED BY COMPANY PRESENT MATTERS OF SUBSTANTIAL PUBLIC INTEREST WHICH REQUIRE JUDICIAL DETERMINATION FOR FUTURE GUIDANCE OF PUBLIC OFFICERS.

The Commission has urged this Court to dismiss this appeal and remand the proceedings to the Commission for reinstatement of its original report and order, because it claims that Company's appeal to the Circuit Court and this proceeding are moot. In support of its request, the Commission cites State ex rel. Laclede Gas Company vs. Public Service Commission, 600 S.W.2d 222 (Mo. App., W.D. 1980). Company does not contest the general proposition set forth in Laclede to the effect that the court will not entertain moot issues where no practical relief can be granted and where no issues of substantial public interest are presented. However, Company strongly disagrees with the Commission's contention that this appeal is, in fact, moot.

It is well settled that a case is moot if a judgment would not provide any practical relief nor have any practical effect upon an existing controversy. Western Auto Supply Co. vs. Banner, 288 S.W.2d 402, 403 (Mo. App., D. St. L. 1956). It is equally well settled that should the court find a case to be moot, it will dismiss the same unless issues of substantial or general public interest are presented for determination. State ex rel. Laclede Gas Company vs. Public Service Commission, 600 S.W.2d 222, 225-26 (Mo. App., W.D. 1980); State ex rel. Dyer vs. Union Electric Company, 312 S.W.2d 151, 155 (Mo. App., D. St. L. 1958); Western Auto Supply Co. vs. Banner, 288

S.W.2d 402, 404-5 (Mo. App., D. St. L. 1956); Morrison vs. State, 252 S.W.2d 97, 100 (Mo. App., D.K.C. 1952).

When determining whether a case should be dismissed for mootness, the court may go outside the record. State ex rel. Donnell vs. Searcy, 347 Mo. 1052, 152 S.W.2d 8, 10 (en banc 1941). Company contends that this Court need not look too far from the record for it to determine that consideration of the issues presented by Company and determination of the same will indeed provide practical relief for Company. The practical relief that Company seeks in this proceeding is some judicial guidance to the Commission with respect to the lawfulness of its proceedings.

The Commission's brief properly reflects that Company has initiated two additional permanent rate proceedings since this case was decided by the Commission (Commission Brief, at 67). What the Commission's brief does not tell the court is why Company has been forced to seek additional rate increases. That reason is painfully clear to Company and other regulated utilities that must contend with the Commission: that is, the Commission continues to follow practices which impose unreasonable restraints on Company's ability to earn a reasonable rate of return.

The Commission also fails to report in its brief that although Company has sought two permanent rate proceedings since the Commission decided this case, Company has not yet received the increase that it requested in this proceeding initiated in August, 1977. A review of Company's recent requests for rate relief and the Commission's responses to those requests is appropriate to demonstrate this point.

On August 4, 1977, Company filed revised electric and gas rate schedules to increase Company's billed jurisdictional electric and gas revenues by $18,723,097 and $2,167,137, respectively. The Commission suspended those schedules, and ultimately, by report and order in Cases No. ER-78-29 and GR-78-30, dated June 23, 1978, effective July 5, 1978, approved increases in Company's electric and gas revenues in the amounts of $976,980 and $421,151, respectively (L.F. 31-32).

On September 1, 1978, Company filed Cases No. ER-79-60 and GR-79-61 requesting increases in electric and gas revenues in the amounts of $22,100,000 and $1,400,000, respectively. Company also requested emergency interim relief in the amount of $8,500,000 for electric revenues in Case No. ER-79-59 on that same date. By order dated December 1, 1978, effective December 15, 1978, the Commission approved $4,281,440 in emergency interim relief for Company. Note that this emergency relief was granted less than six months after the effective date of the Commission's report and order in the proceeding currently before this Court. Not until July 19, 1979 did the Commission issue its report and order, effective July 29, 1979, approving additional electric and gas revenues in Cases No. ER-79-60 and GR-79-61 of $1,351,307 and $46,096, respectively. On October 5, 1979, Company sought additional increases in its electric and gas revenues in the amounts of $28,400,000 and $798,000, respectively. By order dated August 25, 1980, effective September 4, 1980, the Commission granted Company an increase of $9,890,777 for electric revenues while the Commission reduced Company's gas revenues in the amount of $158,876.

On September 5, 1980, one day later, Company filed Case No.

ER-81-85, wherein it requested an increase in its electric revenues in the amount of $29,250,000. The Commission suspended any increase under this proposal until August 3, 1981, by its orders dated September 16, 1980, and October 14, 1980.

On November 5, 1980, Company filed a request for emergency interim relief in the amount of $15,000,000 for its electric revenues. The Commission has taken no action on this request as of the date this brief was prepared.

The above-referenced proceedings are summarized in the chart below:

Case No.	Date Filed	Relief Request	Relief Granted	Effective Date
ER-78-29	8/4/77	$18,723,097	$ 976,980	7/5/78
ER-79-59	9/1/78	8,500,000	4,128,440	12/15/78
ER-79-60	9/1/78	22,100,000	1,351,307	7/29/79
ER-80-118	10/5/79	28,400,000	9,089,707	9/4/80
ER-81-85	9/5/80	29,500,000	Undetermined	Suspended
Unknown	11/5/80	15,000,000	Undetermined	Undetermined
GR-78-30	8/4/77	2,167,137	421,154	7/5/78
GR-79-61	9/1/79	1,400,000	46,096	7/29/79
GR-80-117	10/5/79	798,000	(158,876)	9/4/80

This review illustrates that even though Company has filed three permanent rate proceedings and two emergency interim rate proceedings since the case at bar was decided by the Commission, Company has not yet obtained the relief which it sought in August, 1977.

As a practical matter, this Court must address itself to the following issue: If Company is denied judicial review because its case is moot, then how can Company and others similarly situated ever receive a judicial determination of critical issues without their boards of directors and officers breaching their fiduciary duties by not initiating or greatly delaying new rate proceedings?

The realities are that the Commission can merely grant nominal relief in Case No. 2, and then claim that Company's appeal in Case No. 1 is moot because Company has, in fact, already received a portion of the desired relief. If the court accepts the Commission's position, then Company is effectively denied its right to judicial review of important legal questions.

Company could, of course, simply wait for the appellate decision in Case No. 1 before filing new rate schedules in Case No. 2. However, if this is done, it is denied any increase during the pendency of the appeal, because retroactive ratemaking is not authorized by the statutes governing the filing and suspension of new tariffs. §§393.150, 393.270, RSMo 1978; State ex rel. Utility Consumers Council of Missouri, Inc. vs. Public Service Commission, 585 S.W.2d 41, 58 (Mo. en banc 1979). Furthermore, if Company fails to file a rate proceeding when good managerial judgment so dictates, the directors and officers of Company may be in breach of their fiduciary duties.

Thus, if this Court accepts the Commission's contention that this case is moot, Company is caught in a "Catch 22" position. Such a decision would allow the Commission inadvertently or even purposely to render unlawful and unreasonable decisions. Faced with such decisions, Company would be forced to choose between contesting these decisions and foregoing attempts to receive additional relief during the appellate procedure, on the one hand, or foregoing judicial review and allowing the Commission to ride rough shod over the utility industry, thereby necessitating the filing of one rate case after another, with emergency interim cases sandwiched in between, in an effort to somehow receive some relief, on the other hand.

Should the court find the issues in this case to be moot, it may still review the same if they are important issues of general or substantial public interest. State ex rel. Laclede Gas Company vs. Public Service Commission, 600 S.W.2d 222, 225-26 (Mo. App., W.D. 1980). During a period of decreasing supplies and increasing costs of energy, it is difficult for Company to imagine issues that are of more substantial and general public interest than those presented to the court in this proceeding. More specifically, Company has preserved the following issues for review: (1) that the Commission's report and order is unlawful because the Commission failed to comply with the findings requirements of §563.090, RSMo 1978; (2) that the Commission's report and order unlawfully confiscated Company's property without just compensation; and (3) that the Commission's report and order is unreasonable. Company's argument in support of these contentions involves the following issues: (1) the proper adjustments to the target market/book value to account for preoffering pressure and issuance expenses; (2) the appropriateness of a mechanical mathematical model to be used to determine Company's required rate of return; (3) the consideration of Company's stock dividend policy; (4) the consideration of Company's lower than average equity ratio and its correspondingly higher than average risk factor; and (5) the use of an attrition factor.

Company contends that these issues are of extremely important general public interest. A definitive judicial decision on these issues with instructions to the Commission is essential to Company and other regulated utilities operating in this state to provide adequate

services to the consuming public and to continue to provide a fair return to their shareholders who provide the capital to run this industry. If the court denies Company judicial review of the important public issues involved, the same issues will continue to crop up in nearly every case before the Commission. In effect, accepting the Commission's position with respect to the issue of mootness will allow the Commission to disregard the constitutional and statutory guidelines imposed upon its operations. Regulated utilities will then be forced to forego further rate proceedings while awaiting a determination of the legal issues on appeal for, perhaps, two years or more. In the alternative, the industry would be forced to forego judicial review and simply file one rate case after another. Such was surely not the intention of the General Assembly. The system simply must be more equitable and more responsive than that.

The mootness issue raised by the Commission is not unique. Indeed, the United States Supreme Court addressed this issue in a similar setting in 1911. Southern Pacific Terminal Company vs. Interstate Commerce Commission, 219 U.S. 498, 31 S.Ct. 279 (1911). In Southern Pacific, the Court was asked to rule upon the lawfulness of an order of the Interstate Commerce Commission which required the Southern Pacific Company to cease and desist from granting a particular shipper of cotton seed products preferential treatment over similar shippers in the use of the Port of Galveston, Texas for a period of two years. Southern Pacific, 219 U.S., at 499, 31 S.Ct., at 280. The Commission contended that inasmuch as its order had expired, the case had become moot and should, therefore, be dismissed. The Court rejected the Commission's contention with the following:

> In the case at bar the order of the Commission may to some extent (the exact extent it is unnecessary to define) be the basis of further proceedings. But there is a broader consideration. The question involved in the orders of the Interstate Commerce Commission are usually continuing (as are manifestly those in the case at bar), and these considerations ought not to be, as they might be, defeated, by short-term orders, capable of repetition, yet evading review, and at one time the government, and at another time the carriers, have their rights determined by the Commission without a chance of redress. (emphasis added)

Southern Pacific, 219 U.S., at 515, 31 S.Ct., at 283.

As authority for its position, the Court cited United States vs. Trans-Missouri Freight Association, 166 U.S. 290, 17 S.Ct. 540 (1897), wherein the Court refused to dismiss as moot an appeal to determine the legality of an agreement between the railroads that allegedly violated the Sherman Act after the railroads had voluntarily terminated that agreement. The Trans-Missouri Court stated:

> The mere dissolution of the agreement of the association is not the most important object of this litigation. The judgment of the court is sought upon the question of the legality of the agreement itself for the carrying out of which the association was formed, and if such agreement be declared to be illegal the court is asked not only to dissolve the association named in the bill, but that the defendants should be enjoined for the future. . . .

Trans-Missouri, 166 U.S., at 308, 17 S.Ct., at 546.

The case at bar is not dissimilar to Southern Pacific and Trans-Missouri in that Company is seeking a declaration of the legality of certain practices and procedures of the Commission and for this Court to direct the Commission to comply with the legal determinations of this Court in this, as well as future proceedings.

More recently, in an entirely different context, the Supreme Court addressed the mootness issue. In Roe vs. Wade, 410 U.S. 113,

93 S.Ct. 705 (1973), the Court was asked to review the constitutionality of the law in Texas with respect to abortions. The Court rejected the state's contention that the appeal was moot because the appellant was no longer pregnant by stating:

> But when, as here, pregnancy is a significant fact in the litigation, the normal 266-day human gestation period is so short that the pregnancy will come to term before the usual appellate process is complete. If that termination makes a case moot, pregnancy litigation seldom will survive much beyond the trial stage, and appellate review will be effectively denied. Our law should not be that rigid. Pregnancy often comes more than once to the same woman, and in the general population, if man is to survive, it will always be with us. Pregnancy provides a classic justification for a conclusion of nonmootness. It truly could be "capable of repetition, yet evading review." Southern Pacific Terminal Co. v. ICC, 219 U.S. 498, 515, 31 S.Ct. 279, 283, 55 L.Ed. 310 (1911). (emphasis added)

Roe vs. Wade, 410 U.S., at 125, 93 S.Ct., at 713.

Company contends that while the factual basis in the case at bar and in Roe are significantly different, the same legal principles are involved. The legality of the Commission's rulings on the issues presented by Company will continue to be challenged, because during a highly inflationary period, rate cases will be filed, one after another, unless such legal issues presented by Company are considered and ruled upon by this Court. Consequently, this rate proceeding is a classic justification for a conclusion of nonmootness.

Appellate courts in the states of Michigan, Wisconsin, Massachusett and Idaho have all addressed the mootness issue in a rate case context and all have concluded that the appeals were not moot.

In Intermountain Gas Co. vs. Idaho Public Utilities Commission, 98 Idaho 718, 571 P.2d 1119 (1977), the Idaho Public Utilities

Commission (IPUC) contended that Intermountain's appeal from the decision in a rate case entered in 1975 was moot because of a superseding order entered in a 1976 rate case. The Idaho Supreme Court rejected that contention with the following:

> More importantly, Intermountain argues that the procedures questioned here present the classic case for review in that they create a recurring problem which, in the very nature of things, will always escape review. In today's inflationary economy, a later rate application will frequently have superseded the order in dispute before the Supreme Court's timetable permits appellate review thereof. We agree. The matters considered herein are of on-going importance to the operation of the Commission and procedural errors which we note can be avoided by the Commission in the future.

Intermountain Gas Co., 571 P.2d, at 1121.

Company is certainly confronted with an inflationary economy as was Intermountain Gas, thus, requiring frequent superseding orders for rate relief. Furthermore, the issues raised by Company in this appeal are matters of ongoing importance that will reoccur in many future rate proceedings. Consequently, the reasoning of Intermountain Gas Co. applies as well to the case at bar.

In Milwaukee & Suburban Transport Corp. vs. Public Service Commission, 268 Wis. 573, 68 N.W.2d 552 (1955), the court was asked to rule upon the question of whether the depreciation method used by the Commission resulted in unreasonable and confiscatory fares. The Commission contended that a superseding fare order rendered the appeal moot. Rejecting this contention, the court stated:

> The issue over the method of computation of depreciation presents a continuing controversy, which was not ended by the September 17, 1953 fare order being superseded by the 1954 fare orders, and therefore the controversy presented in the present review proceedings is not moot.

Milwaukee, 68 N.W.2d, at 556.

In Board of Gas and Electric Commissioners of Middleborough vs. Department of Public Utilities, 363 Mass. 433, 294 N.E.2d 866 (1973), the court considered a challenge to the legality of G.L. c. 164, §94 as amended through St. 1963, c. 615, §1 which authorized the Department to suspend the operation of certain utility rates for up to a 10-month period. Although neither party raised the mootness issue, the court addressed the same after noting that the disputed suspension order had been revoked by the Department. In fact, both parties urged the court to reach the merits of the case. The court addressed the issue by stating that:

> It was represented by counsel that this is a frequently recurring question which should be answered to prevent further disagreements between municipal light boards and the Department. They represent further that it is very difficult to litigate the question to the point of presenting it to an appellate court for decision before the expiration or other termination of the suspension of the rate schedules by the Department. We recognize this practical difficulty and we conclude that we should now answer the questions and thereby eliminate or reduce further disagreements between governmental agencies on this subject. In two comparable situations the United States Supreme Court granted relief by describing them as truly "capable of repetition, yet evading review" by an appellate court. Southern Pac. Terminal Co. v. Interstate Commerce Commn., 219 U.S. 498, 515, 31 S.Ct. 279, 283, 55 L.Ed. 310, and Roe v. Wade, ____ U.S. ___, 93 S.Ct. 705, 35 L.Ed.2d 147. (emphasis added)

Board of Gas and Electric Commissioners, 294 N.E.2d at 868-69.

The appellate courts in the State of Michigan have rendered particularly enlightening decisions on cases nearly identical to the case at bar. Michigan Bell Telephone Co. vs. Public Service Commission, 85 Mich. App. 163, 270 N.W.2d 546 (1978); General Telephone Company of Michigan vs. Michigan Public Service Commission, 78 Mich. App. 528,

260 N.W.2d 874 (1977). In Michigan Bell and General Telephone, the companies had filed revised rate schedules and received some of the requested relief before the presentation of their appellate cases. Furthermore, in both cases, the companies conceded that General Telephone of Michigan vs. Public Service Commission, 341 Mich. 620, 67 N.W.2d 882 (1954) and Michigan Bell Telephone Co. vs. Public Service Commission, 315 Mich. 533, 24 N.W.2d 200 (1946), precluded them from receiving retroactive rate relief. Consequently, the courts in Michigan Bell and General Telephone were confronted with nearly the identical situation as this Court is presented with in the case at bar.

In General Telephone, the court stated:

> The Michigan Public Service Commission also has a statutory duty to provide just and reasonable rates. . . . (citation omitted) We think that the Commission has erred in this case and that such errors are likely to recur in the future unless this Court addresses certain issues raised by the parties.

General Telephone, 260 N.W.2d, at 877. Thus, the court rejected the Commission's contention that the appeal was moot and afforded the company judicial review of the important legal issues before it.

In Michigan Bell, the court stated the following with regard to the issue of mootness:

> The circuit court rejected the Commission's theory for two reasons. First, the statutory scheme for rate setting contemplates review of Commission determinations on appeal. M.C.L. §§460.4, 462.26; M.S.A. §§22.13(4), 22.45. Since it is Michigan Bell's practice to seek new rate determinations after each Commission decision, and since the appeal process generally takes longer than the Commission's resolution of each rate case, almost inevitably new rates will be set before the appeal on the old rates is decided. If the new rate determination rendered the contested issues in the old rate case moot, the review scheme would be rendered a nullity.

> Second, even assuming no relief could be granted in this case, the mootness doctrine has an exception permitting review where the issues involved are of continuing public interest, capable of repetition, yet also capable of evading review. See Southern Pacific Terminal Co. v. Interstate Commerce Comm., 219 U.S. 498, 31 S.Ct. 279, 55 L.Ed. 310 (1911), Alton & S.R. Co. v. International Ass'n of Machinists & Aerospace Workers, 150 U.S. App. D.C. 36, 43, 463 F.2d 872, 879 (1972).
>
> The Commission made a similar mootness argument before this Court in the recent case of General Telephone Co. of Michigan v. Public Service Comm., 78 Mich. App. 528, 260 N.W.2d 874 (1977). In General Telephone, the utility conceded that a subsequent rate increase precluded relief in that particular case. As a consequence, this Court also assumed that the retroactivity doctrine would preclude relief. However, this Court reached the substantive issues presented under the second rationale advance by the trial court in the instant case, the public interest exception to the mootness doctrine, because the errors were likely to recur in the future.
>
> The mootness issue presents two sub-issues. First, whether the substantive issues are moot because no relief can be granted in this case, and second, if moot, whether we may reach the substantive issues under the public interest exception to the mootness doctrine. Michigan Bell primarily argues the second sub-issue, but raises by implication the first sub-issue, since it requests that relief be granted in the instant case.
>
> Assuming mootness, the public interest exception clearly applies in this case. The BIS payments are ongoing expenditures which will be taken into account in future rate cases, and the amortization of the state income tax reserve will extend over five years. Unless we reach these issues in the instant case, they may never be resolved by the courts. (emphasis added)

Michigan Bell, 270 N.W.2d, at 547-48.

Company contends that the reasoning of the Michigan, Wisconsin, Massachusetts and Idaho courts apply to the case at bar. As previously discussed, the issues presented by Company are of a recurring nature. Furthermore, these are issues of substantial and general public interest. Therefore, for the reasons herein stated, Company respectfully

requests this Court to reject the Commission's contention that this appeal should be dismissed for mootness, and prays that this Court rule on the important legal issues submitted to it in the remaining portions of Company's brief.

II.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE IS NOT SUPPORTED BY ADEQUATE FINDINGS OF FACT AND CONCLUSIONS OF LAW AS REQUIRED BY §536.090, RSMO 1978, IN THAT SAID FINDINGS AND CONCLUSIONS FAIL TO DISCLOSE:

(A) WHAT METHOD WAS USED TO DETERMINE COMPANY'S ALLOWED RETURN ON EQUITY, A MAJOR ISSUE IN THE CASE;

(B) ANY REFERENCE TO AN ATTRITION ALLOWANCE, A MAJOR ISSUE IN THE CASE;

(C) WHETHER ANY ALLOWANCE FOR PREOFFERING PRESSURE WAS MADE, ANOTHER ISSUE IN THE CASE; AND

(D) WHETHER THE COMMISSION CONSIDERED INCREASED FLOTATION COSTS, ANOTHER ISSUE IN THE CASE.

The Public Service Commission is required by law to prepare findings of fact and conclusions of law. Section 536.090, RSMo 1978, provides, in part, that:

> Every decision and order in a contested case . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order. . . .

The requirements of this section do apply to orders and decisions of the Public Service Commission. State ex rel. St. Louis Public Service Co. vs. Public Service Commission, 291 S.W.2d 95, 93 (Mo. en banc 1956). The statute does not specify the precision with which the findings and conclusions must be drawn. The Missouri appellate courts, however, have construed this statute. In the first of a line of recent cases, Iron County vs. State Tax Commission, 480 S.W.2d 65 (Mo. 1972), the court held that a recital of the evidentiary facts or a statement of the chronology of events in the case is insufficient. Rather, the

findings of fact must demonstrate how factual disputes were resolved, thus providing an explanation for the basis upon which the agency reached its conclusion. As stated by the court:

> the purpose in requiring such to be done is in order that the Circuit Court can know the basis for the agency's decision in order that it, the Circuit Court, can perform its limited review function and not substitute its discretion for that of the administrative agency.

Iron County, 480 S.W.2d, at 70.

The next important Supreme Court case interpreting §536.090, was Stephen & Stephen Properties, Inc. vs. State Tax Commission, 499 S.W.2d 798 (Mo. 1973). The Stephen court indicated that, in reviewing an administrative decision, it was bound by the agency's findings if the same were supported by competent and substantial evidence. However, the court stated that it could not infer findings from the ultimate decision of an administrative agency because such an inference would defeat the limited scope of review in that it would allow the court to review both the law and the facts on appeal. The court went on to outline the five practical reasons for the findings requirement:

> These justifications include: (1) the facilitation of judicial review; (2) preventing judicial usurpation of administrative functions; (3) to protect against careless or arbitrary action (the requirement of findings, evokes "care on the part of the trial judge in ascertaining the facts." . . .); (4) to help parties plan their cases for rehearing and for judicial review; and (5) to keep the agencies within their jurisdiction. (citations omitted)

Stephen, 499 S.W.2d, at 804-5.

In St. Louis County vs. State Tax Commission, 515 S.W.2d 446 (Mo. 1974), the court considered the sufficiency of findings and conclusions of the State Tax Commission with respect to a particular assessment. The parties to the action differed sharply with respect to the appropriate method of evaluation and with respect to the appropriate factors

to be used in a particular evaluation method. One paragraph of the Commission's findings stated the following:

> With due deference to the testimony of both parties, the Commission finds the assessed value of the property to be $759,420, as of January 1, 1972.

St. Louis County, 515 S.W.2d, at 450. The court held that such a conclusory statement by the Commission with respect to this assessment failed to resolve the factual issues raised by the parties, was vague, uncertain and provided no record from which the court could determine the basis of the Commission's assessment conclusion.

The court did note that it was possible that the Commission had taken the figures proffered by the opposing parties, split the difference and then divided by three to reach the assessed valuation. Although that figure, either by design or by coincidence, equaled the valuation assessed by the Commission, the court found the same to be arbitrary and insufficient. Summarizing the shortcomings of the findings, the court stated:

> They fail to resolve contested issues of fact; fail to find pertinent uncontroverted facts; fail to demonstrate the basis of the commission's ultimate decision; fail to state what factors the commission considered relevant to a determination of value and fail to indicate the effect of the chosen factors on the value of the property.

St. Louis County, 515 S.W.2d, at 451.

This Court has, on two recent occasions, considered the requirements of §536.090. Glasnapp vs. State Banking Board, 545 S.W.2d 382 (Mo. App., D.K.C. 1976); Century State Bank vs. State Banking Board of Missouri, 523 S.W.2d 856 (Mo. App., D.K.C. 1975).

In Century State Bank, the court noted the scope of judicial review of agency action was to make a determination whether the order

is supported by competent and substantial evidence. In order for a court to make that determination, the findings by the agency must be sufficient to resolve disputed issues of fact and law. In that the court may not substitute its discretion for that of the agency, the findings requirement is, as a practical matter, the only method by which the court can determine whether an agency action is supported by competent and substantial evidence. After considering this, the court noted the five practical reasons for the findings requirement as stated in Stephen & Stephen Properties, Inc. vs. State Tax Commission, 499 S.W.2d 798, 804-5 (Mo. 1973).

The Century State Bank court found that the Commission's order failed to state which evidence it had accepted and which it had rejected. A statement of the bare ultimate conclusions reached by the agency was held to be insufficient for the court to determine whether or not the agency's decision was supported by competent and substantial evidence.

In 1976, this Court considered Glasnapp vs. State Banking Board, 545 S.W.2d 382 (Mo. App., D.K.C. 1976). In Glasnapp, the court indicate that precisely how far an administrative agency must go in setting forth its finding of facts depends upon the particular issues involved in each case.

> For this reason, it has been held that "[t]he zone of propriety between the extremes of mere conclusion and undue particularity has never been accurately defined. It has been said that all of the essential facts upon which the order is based must be found." Bryan v. Community State Bank of Bloomington, 285 Minn. 226, 172 N.W.2d 771, 775 (1969). The overall principle generally subscribed to is summarized in 2 Am. Jur. 2d Administrative Law §455, p. 268, as follows: "The most reasonable and practical standard is to require that findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to

> review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence. (emphasis added)

Glasnapp, 545 S.W.2d, at 387.

Based upon the review of these five cases, it is clear that the findings of fact required by §536.090, RSMo 1978, must be more than a mere statement of the ultimate findings or conclusions of the agency, yet less than a recital of every evidentiary fact. As a good rule of thumb, the findings of fact are sufficient if they meet the five purposes for requiring findings of fact. Of those five purposes, the Missouri courts have placed strong emphasis upon the requirement that the findings of fact provide sufficient detail and resolve the disputed issues of fact, so that the reviewing court will know whether the decision is supported by competent and substantial evidence without resorting to the transcript.

In accordance with the Commission's grant of power, in §§393.150 and 393.270, RSMo 1978, to determine rates which an electric or gas corporation may charge its customers, §393.230, RSMo 1978, requires the Commission to ascertain the value of property devoted to public use by an electric or gas utility and ascertain every fact having any bearing on such value. Construed together, the statutes direct the Commission to determine just and reasonable rates of return upon the property of the gas or electric utility company which is used and useful in the public service. State ex rel. Martigney Creek Sewer Co. vs. Public Service Commission, 537 S.W.2d 388 (Mo. en banc 1976); State ex rel. Missouri Water Company vs. Public Service Commission, 308 S.W.2d 704 (Mo. 1957); State ex rel. Capital City Water Company vs. Public Service Commission of Missouri, 252 S.W. 446 (Mo. en banc

1922). The statutory directions necessarily require determinations by the Commission with respect to the inclusion or exclusion of rate base items, cost of service items (revenues and expenses) and cost of money/rate of return (on common equity and on rate base). State ex rel. Hotel Continental vs. Burton, 334 S.W.2d 75 (Mo. 1960). An insufficient or inadequate finding on any given issue would preclude a reviewing court from determining whether the decision was supported by substantial and competent evidence and would not aid the parties in planning their cases for rehearing or for judicial review. Consequently such a defective finding would not meet the requirements for adequate findings pursuant to §536.090, RSMo 1978.

Having considered the general requirements for findings of fact for an administrative decision, it is necessary to turn to the particular findings of fact with respect to the issue of cost of money/rate of return in the case at bar. The portion of the report and order dealing with this issue consists of five paragraphs, begins at the bottom of page 3 of the report and order and concludes near the center of page 4 (L.F. 14-15). In this cavalier fashion, the report and order disposes of serious and substantial issues involving hundreds of pages of testimony and dozens of exhibits. A brief review of this portion of the report and order is necessary.

The Commission first concludes that the "appropriate capital structure" of Company for this case is as follows (L.F. 14):

Type of Capital	Capitalization Ratio	Cost	Weighted Cost
Common Equity	80.00%	12.70 %	3.81%
Preferred & Preference Stock	16.00	8.624	1.38
Long Term Debt	14.00	7.129	3.85
Return on Rate Base	100.00%		9.04%

The only independent variable within the capital structure that was not stipulated is the cost of common equity. Consequently, the 12.70 percent cost of common equity figure contained in this paragraph is nothing more than a recital by the Commission of the ultimate contested issue in the area of rate of return without any supporting findings.

The second paragraph contains two conclusions. First, the Commission states that the Company's common equity should sell at 1.06 times its book value, which price level would permit the Company to receive proceeds exceeding book value (thus avoiding dilution of existing shareholders' interest resulting from issuances below book value) on issuances of common equity (L.F. 15). The Commission then proceeds to pick from the air a 12.70 percent rate of return on common equity as the "appropriate [rate of return on common equity] to achieve that market price" (L.F. 15). There is nothing to indicate how it chose that return.

In the third paragraph of this portion of the report and order, the Commission simply dismisses from its consideration the issue of Company's stock dividend policy as "a matter wholly within the Company's managerial and financial discretion . . ." (L.F. 15). The Commission goes on to state that it will not consider the Company's stock dividend policy in determining the required rate of return (L.F. 15).

The fourth paragraph, relating to rate of return, acknowledges Company's relatively low equity ratio and states that this factor is also "within the discretion of the Company's management . . ." (L.F. 15) and that Company's low equity ratio will not be considered in determining the required rate of return, because this factor "has no substantial effect upon the expectation of investors . . ." (L.F. 15).

The final paragraph of this part of the findings and conclusions recites boiler plate references to Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944); Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 143 S.Ct. 675 (1923). The Commission concludes with the contention that the 12.70 percent ratio on common equity, which translates into a 9.04 percent return on net original cost-rate base, will meet the requirements imposed by Hope Natural Gas and Bluefield Waterworks (L.F. 15).

These findings and conclusions fail to meet the five practical tests established by Missouri case law. Four specific deficiencies are: (1) the method or reasoning used to determine the return on equity is not disclosed; (2) the attrition issue is ignored; (3) the claimed allowance for preoffering pressure is ignored; and (4) the recent trend of increased flotation costs is ignored.

Company's direct witness, John R. Baker, used a discounted cash flow (DCF) approach and recommended a return on equity of 15.2 percent, which translates into a rate of return of 10.08 percent on net original cost rate base, including an attrition factor of .28 percent (T 372-390). The method used is well established, recognized heretofore in Missouri and in other jurisdictions, including the Federal Power Commission, now the Federal Energy Regulatory Commission.

Staff witness Daniel Burkhardt used a regression model developed from 1976 statistics of 95 electric or combination electric and gas utility companies and concluded that an appropriate return on equity was within a range of 12.21 percent to 13.21 percent, which translates

to a range of 8.849 percent to 9.149 percent on rate base, with an unquantified attrition factor recommended (T 460-501).

Nowhere in the report and order is the source of the 12.7 percent approved return on equity given. Presumably, the approved rate of return lies somewhere within the Staff's range and it does lie, by chance or design, near the midpoint (12.71%) of the Staff's recommended return, excluding any allowance for attrition.

This portion of the Commission's findings and conclusions is very similar to that in St. Louis County vs. State Tax Commission, 515 S.W.2d 446 (Mo. 1974). As previously stated, in St. Louis County, the Supreme Court held that the finding with respect to the numerical value for the valuation was improper and insufficient for it failed to resolve the issues of fact raised by the parties and failed to demonstrate the basis of the ultimate decision in arriving at the assessed valuation. St. Louis County, 515 S.W.2d, at 451. Such is the case at bar. The Company's direct witness used a method for determining the return on equity that was quite different from that used by the Staff's witness. The return derived from these two approaches was significantly different However, the Commission wholly failed to state whether it approved either the Company's or the Staff's procedure. In fact, the findings of the Commission make it just as likely that the Commission utilized neither method, and simply allowed some rate of return between the high and the low recommendations.

Findings and conclusions such as these obviously fail to meet the five practical tests for findings and conclusions. For example, the Commission's record certainly does not facilitate judicial review,

prevent judicial usurpation of administrative functions nor help the parties plan their case for judicial review.

The second unanswered question with respect to this portion of the findings and conclusions is whether the Commission's approved rate of return makes any allowance for an attrition factor. An attrition factor is an allowance calculated to offset inflationary factors which create a shortfall in an allowed rate of return (T 497). Both Company witness Baker and Staff witness Burkhardt recommend an attrition allowance (T 387-390, 499).

Company witness Baker added an attrition adjustment of .28 percent to the rate of return on original cost net rate base (T 387-390). This adjustment was based upon an analysis of the erosion in common equity return actually earned compared with that found reasonable and authorized by the Commission. The amount was determined by comparisons of authorized returns with returns actually earned as portrayed in Company Exhibit 1, Section 7, Schedule 2 (T 388). During the previous five years, the Company averaged earnings of only 80 percent of the amount authorized and the witness recommended an attrition allowance which was only one-third of the attrition actually experienced as a minimum for Company to have an opportunity actually to earn the approved rate of return (T 388-389). The attrition factor is computed in Company Exhibit 1, Section 7, Schedule 6 (T 389). As is discussed in a later portion of this brief, there is ample authority in other jurisdictions for the allowance of an attrition factor in ratemaking proceedings (Point III.C, infra).

Staff witness Burkhardt also recognized attrition (T 496-499). He examined a 57-month period beginning in January, 1973, and ending

in September, 1977, showing allowed returns and earned returns in Staff Exhibit 2, Schedule 21, and with a graphic portrayal in Schedule 22. The witness went on to say that if, during past years, as both Company and Staff exhibits demonstrate, the Company "has consistently been unable to earn the return authorized by the Commission, this fact should be considered" (T 497). Mr. Burkhardt also stated that the economic environment which produced past attrition should be compared with probable future circumstances (T 497). He listed five factors which he regards as the primary determinants of attrition, and then concluded that he saw "no possibility for secession in new plant additions, inflation or the continued issuance of new capital above embedded debt cost" (T 498). Furthermore, the witness went on to say that the same factors which contributed to attrition in the past will probably persist in the future. Staff witness Burkhardt concluded by stating that the Commission could justifiably allow Company a return increment to offset the effects of attrition (T 498-499).

The Commission states that the use of certain devices such as a year-end rate basis, annualization of certain revenue and expense items and the like, tend to ameliorate the effects of attrition (Commission Brief, at 56). However, in every previous rate case involving rates in effect during the past five years, those same techniques were used, and yet, Company Exhibit 1, Section 7, Schedule 2, shows that even with those compensating factors, Company has suffered an average 20 percent shortfall of the return authorized by the Commission (T 388-389, 2254).

The Commission's report and order makes no mention of an attrition allowance. It can be assumed that the Commission did not allow such a

factor. However, that would merely be speculative. Once again, the absence of appropriate findings and conclusions by the Commission precludes the parties from adequately preparing their case for judicial review and hinders this Court in determining whether the conclusions of the Commission are supported by competent and substantial evidence.

The remaining two specific defects in the findings and conclusions with respect to the rate of return issue are both factors which must be considered in determining the appropriate target market/book value (T 2523-2524). These issues are preoffering pressure and flotation costs. Flotation costs are those expenses incurred by the Company in the actual issuance of additional equity, including brokers' fees, attorneys' fees and printing expenses. Preoffering pressure is a phenomenon that occurs in the market when there is an existing supply of a commodity, such as common stock, and that supply is increased without a corresponding increase in obvious buyers. When the supply increases, yet the demand does not increase correspondingly, the price of the commodity is expected to drop.

Staff witness Burkhardt recommended a target market/book value of 106 percent, which he contended would permit the Company's new common offerings to sell without diluting the value of existing common stock (T 473). Mr. Burkhardt arrived at the 106 percent figure by taking the book value of Company's common stock and adding a margin of 6 percent to cover flotation costs. The 6 percent flotation cost was computed by taking the average cost of Company's last three common issues.

Mr. Burkhardt did not recommend any adjustment to the target market/book value to offset the effect of preoffering pressure (T 2295).

Nor did he consider whether Company's past common issues have experienced the effects of preoffering pressure (T 2297). However, he did admit that the effect of preoffering pressure does occur with respect to issues of additional common stock (T 2296). In fact, Mr. Burkhardt indicated that he had previously included an allowance for preoffering pressure when employing a discounted cash flow approach (T 2295, 2297). This allowance was made "under the lump 10 percent" margin that was added to the market price to compensate for both preoffering pressure and flotation costs (T 2295, 2297).

Company witness Dr. Eugene F. Brigham indicated that the Staff's estimated 6 percent margin on book price for flotation cost was too low (T 2523, 2622), and that he did not believe "that the Company could confidently sell stock and be sure that it could sell stock at above book, if they started off at 1.06 market/book price" (T 2622).

Mr. John R. Baker, Company witness, testified with respect to the existence of preoffering pressure in Company's most recent offering (T 2702-2705; Company Exhibit 37). Mr. Baker demonstrated in Company Exhibit 37 that during Company's last preoffering period (that period between the date of the announcement of the offering and the date of the actual offering) the market price of Company's common stock declined 8.70 percent as compared to a decline of 1.51 percent in the Standard & Poor's Utility Index. This differential in excess of 7 percent is quantifiable preoffering pressure for Company's common stock.

Dr. Brigham also testified with respect to preoffering pressure. Although Dr. Brigham did not make a study such as Mr. Baker's to determine the existence of preoffering pressure with respect to Company's

common stock issuances (T 2624-2625), he stated that "market pressure does exist" (T 2523). Furthermore, Dr. Brigham stated that both preoffering "market pressure and flotation costs need to be incorporated into the target market/book ratio" (T 2523-2524).

As this review demonstrates, there is conflicting evidence with respect to the appropriate target market/book price. The Commission's report and order does not demonstrate why it chose 106 percent market/book price as the appropriate target. Nor does the report and order make any finding with respect to preoffering pressure. The undisputed testimony was that preoffering pressure does exist, both theoretically and in the most recent actual issuance by Company. These two faults once again preclude the findings and conclusions contained in this report and order from complying with the mandate of §536.090, RSMo 1978. The five practical tests which this Court and the Supreme Court of Missouri have repeated on numerous occasions have been totally ignored by the Commission. As a result, Company has been hindered in its effort to prepare its case for judicial review, and certainly this Court is precluded from determining whether, in fact, the Commission's decision is supported by competent and substantial evidence upon the record as a whole without resorting to the transcript.

The Circuit Court of Cole County recognized these deficiencies in the Commission's report and order. They are not mere technical deficiencies, rather they are substantive. Any one of the four defects in the findings and conclusions that Company has discussed, standing alone, would have justified the Circuit Court in reversing this portion of the Commission's report and order. When the four deficiencies are cumulatively considered, there can be little, if any, doubt that the

Circuit Court acted appropriately in reversing the Commission's decision on the cost of money/rate of return issue. Therefore, Company urges this Court to affirm the Circuit Court in its reversal, based upon this portion of the report and order.

III.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE UNLAWFULLY RESULTS IN CONFISCATION OF COMPANY'S PROPERTY BY TAKING ITS PROPERTY FOR PUBLIC USE WITHOUT JUST COMPENSATION, IN THAT THE COMMISSION:

(A) FAILED TO ADJUST THE TARGET MARKET/BOOK VALUE FOR PREOFFERING PRESSURE;

(B) IGNORED RELEVANT AND SIGNIFICANT SHORTCOMINGS INHERENT IN THE METHODOLOGY USED BY THE STAFF IN DETERMINING COMPANY'S RETURN ON EQUITY (ASSUMING AND SPECULATING THAT THE STAFF'S METHODOLOGY WAS RELIED UPON, ALTHOUGH THE REPORT AND ORDER IS SILENT ON THE MATTER); AND

(C) FAILED TO INCLUDE AN ATTRITION FACTOR IN COMPUTING COMPANY'S REQUIRED RATE OF RETURN;

ALL RESULTING IN RATES THAT DO NOT PROVIDE COMPANY WITH AN OPPORTUNITY TO EARN A JUST AND REASONABLE RETURN ON THE VALUE OF ITS PROPERTY USED IN THE PUBLIC SERVICE.

Generally

Sections 393.150 and 393.270, RSMo 1978, authorize the Commission to set the maximum rates which an electric utility may charge its customers. Company does not deny the fact that the Commission is granted rather broad discretion in setting those maximum rates. However, there are limits imposed upon the exercise of that discretion. As stated by the Supreme Court in Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 289, 43 S.Ct. 544, 547 (1923):

> It must never be forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership.

Company contends that the Commission has gone beyond the constraints of Missouri ex rel. Southwestern Bell Telephone Co., by approving confiscatory rates which amount to public taking of private property without just compensation. U.S. Const. amend. V, XIV; Mo. Const. art. I, §26.

The United States and Missouri Constitutions require the Commission to authorize rates which entitle Company an opportunity to earn a just and reasonable return on the fair value of its property used in the public service. Bluefield Waterworks and Improvement Co. vs. Public Service Commission of West Virginia, 262 U.S. 679, 692, 43 S.Ct. 675, 679 (1923); State ex rel. Missouri Water Company vs. Public Service Commission, 308 S.W.2d 704 (Mo. 1957). The goal of establishing just and reasonable rates is easily stated; however, both courts and rate-making bodies have wrestled with the application of this standard for years. Without citing lengthy quotations, Company will attempt to set forth the basic rules, or guidelines, which the courts have established for the application of the just and reasonable rates standard.

The starting point in determining the rate of return that will constitute just compensation is that the Commission must attempt to set rates that will permit Company

> to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . .

Bluefield Waterworks, 262 U.S., at 692, 43 S.Ct., at 679. Furthermore, the rate must be sufficient to assure confidence in the Company's soundness and must be adequate to supply enough revenue, not only for operating expense, but also for capital costs, including service on the

debt and dividends of its stock, and there must be a return to the equity owner commensurate with returns on investments in other enterprises having corresponding risk. Bluefield Waterworks, 262 U.S., at 692, 43 S.Ct., at 679. Consequently, the determination of whether the rate authorized in any particular case is confiscatory depends upon the particular facts of the case relating to the circumstances under which the subject company operates, the general economic conditions, the locality in which the subject company operates and the risk associated with investments in the particular company.

A second general rule is that the Commission must make its determination of what is just compensation "by the exercise of a fair and enlightened judgment, having regard to all relevant facts." Bluefield Waterworks, 262 U.S., at 692, 43 S.Ct., at 679. An extremely important fact that must be considered in making this determination is the actual experience of the subject company. Smith vs. Illinois Bell Telephone Co., 282 U.S. 133, 160, 51 S.Ct. 65, 73 (1930); Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 151, 163-64, 54 S.Ct. 658, 663 (1934). As stated by the Court in Lindheimer, 292 U.S., at 164, 54 S.Ct., at 663: "Elaborate calculations which are at war with realities are of no avail."

Another very important consideration in determining whether particular rates are confiscatory is the risk which will be encountered by investors in a particular company. Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944); United Rys. & Electric Co. of Baltimore vs. West, 280 U.S. 234, 249, 50 S.Ct. 123, 125 (1930). Consequently, whereas a given rate of return may be

sufficient for a relatively secure company to attract adequate capital to properly discharge its duties, that same rate of return may be totally insufficient for a less stable and thereby riskier company to attract the capital that is required for it to properly discharge its duties.

The corollary to the rule that requires the Commission to consider all relevant facts when it is called upon to exercise its discretion in setting maximum rates that a public utility may charge its customers is that the Commission may not arbitrarily ignore evidence that is relevant to the establishment of those rates. Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 289, 43 S.Ct. 544, 547 (1923). No matter how

> difficult may be the ascertainment of relevant and material factors in the establishment of just and reasonable rates, neither impulse nor expediency can be substituted for the requirement that such rates be "authorized by law" and "supported by competent and substantial evidence upon the whole record." (citation omitted)

State ex rel. Missouri Water Company vs. Public Service Commission, 308 S.W.2d 704, 720 (Mo. 1957).

Company contends that the rate of return authorized by the Commission does not provide it with an opportunity to earn a fair rate of return and that said rate is thereby confiscatory. In support of this proposition, Company will examine three specific areas, to-wit: (1) the failure of the Commission to adjust the target market/book value for preoffering pressure; (2) assuming and speculating that the Commission used the method recommended by the Staff (although the report and order is silent on the matter) to compute the authorized return on equity for Company. there are significant matters and shortcomings

inherent in the use of that method in this case; and (3) the failure of the Commission to include an attrition factor.

III.A.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE UNLAWFULLY RESULTS IN CONFISCATION OF COMPANY'S PROPERTY BY TAKING ITS PROPERTY FOR PUBLIC USE WITHOUT JUST COMPENSATION, IN THAT THE COMMISSION FAILED TO ADJUST THE TARGET MARKET/BOOK VALUE FOR PREOFFERING PRESSURE, RESULTING IN RATES THAT DO NOT PROVIDE COMPANY WITH AN OPPORTUNITY TO EARN A JUST AND REASONABLE RETURN ON THE VALUE OF ITS PROPERTY USED IN THE PUBLIC SERVICE.

Two methods for reaching the required return on equity were used in this rate proceeding: Company utilized a discounted cash flow (DCF) analysis while Staff's witness developed a regression model. The ultimate goal of both methods is to select a rate of return on common equity that would allow Company to sell its common stock at an appropriate target market/book price. Such a price will permit additional net sales of common stock without dilution--that is, at or above book value. If the target market/book price is improper, then the recommended rate of return will also be incorrect. Consequently, the choice of the appropriate target market/book price is essential to both methods used in this proceeding.

This leads to the first basis for Company's contention that the authorized rate of return is confiscatory in that the Commission failed to adjust the target market/book price for preoffering pressure. The evidence adduced concerning preoffering pressure is thoroughly reviewed in Point II, supra. Although a detailed discussion of those facts will not be conducted in this portion of Company's brief, a short review is required.

The Commission's report and order makes no mention of preoffering pressure. The Commission did adopt Staff's recommended target market/book price of 106 percent (L.F. 15). Consequently, one can speculate that the Commission adopted the Staff's basis for this recommendation.

With respect to preoffering pressure, recall that both Staff and Company witnesses acknowledge the existence of preoffering pressure (T 2296, 2523, 2702-2705; Company Exhibit 37). However, in this proceeding, Staff witness Burkhardt did not make any study to determine the existence of or to quantify the amount of preoffering pressure with respect to this Company's prior stock issuances (T 2297); consequently, his recommended target market/book price of 106 percent of book value did not include any allowance for preoffering pressure (T 2295). Company witness John R. Baker demonstrated in Company Exhibit 37 that during the Company's last preoffering period the market price of the Company's common stock declined 8.70 percent as compared to a decline of 1.51 percent in the Standard & Poor's Utility Index (T 2702-2705). This differential in excess of 7 percent is quantifiable preoffering pressure for Company's common stock. Company witness Dr. Eugene F. Brigham stated that "market pressure does exist" (T 2523) and that both preoffering pressure and flotation costs must be incorporated into the target market/book price (T 2523-2524).

This brief review of the evidence establishes that although the Commission heard uncontradicted evidence as to the existence of quantifiable preoffering pressure with respect to Company's most recent stock issue, the Commission failed to make any allowance for that pressure in setting the target market/book price at 106 percent book value. The

report and order offers no explanation for this action. Such a decision contravenes the requirement that the Commission determine just compensation "by the exercise of fair and enlightened judgment, having regard to all relevant facts." (emphasis added) Bluefield Waterworks, 262 U.S., at 692, 43 S.Ct. 679. Such a decision is also contrary to the Supreme Court's mandate in Missouri ex rel. Southwestern Bell Telephone Company, 262 U.S., at 289, 43 S.Ct. 547, that the Commission may not arbitrarily ignore evidence that is relevant to the establishment of those rates.

The effect of the Commission's decision to ignore preoffering pressure is to set an artificially low target market/book price for Company's stock, resulting in Company's inability to realize book value on the sale of its common stock. Necessarily, any rate of return based on an artificially low target market/book price will result in confiscatory rates. The Circuit Court of Cole County fully understood the adverse impact upon Company of the Commission's decision to set an artificially low market/book value. Consequently, the Circuit Court did not err in reversing that portion of the Commission's report and order concerned with rate of return because the same prescribed confiscatory rates which would result in the taking of Company's property without just compensation.

III.B.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE UNLAWFULLY RESULTS IN CONFISCATION OF COMPANY'S PROPERTY BY TAKING ITS PROPERTY FOR PUBLIC USE WITHOUT JUST COMPENSATION, IN THAT THE COMMISSION IGNORED RELEVANT AND SIGNIFICANT SHORTCOMINGS INHERENT IN THE METHODOLOGY USED BY THE STAFF IN DETERMINING COMPANY'S RETURN ON EQUITY (ASSUMING AND SPECULATING THAT THE STAFF'S METHODOLOGY WAS RELIED UPON, ALTHOUGH THE REPORT AND ORDER IS SILENT ON THE MATTER),

RESULTING IN RATES THAT DO NOT PROVIDE COMPANY WITH AN OPPORTUNITY TO EARN A JUST AND REASONABLE RETURN ON THE VALUE OF ITS PROPERTY USED IN THE PUBLIC SERVICE.

The Commission authorized a 12.70 percent rate of return on equity (L.F. 15). This authorized rate compares with 12.71, the midpoint of the range recommended by Staff witness Burkhardt (T 460). The findings are silent as to whether the Commission adopted the Staff's method of analysis in deriving this rate of return. However, if the approved rate of return is based on Staff's statistical model, that model must be carefully scrutinized to determine what factors were considered and what relevant factors were ignored in deriving the authorized rate of return for Company.

Staff's case on return relied exclusively upon a statistical regression model presented by Staff witness Burkhardt (T 460-501). When considering Mr. Burkhardt's testimony, two very important facts should be kept in mind. First, although Mr. Burkhardt presented a statistical model to the Commission and asked it to accept the results of that model, he expressly disavowed any expertise in the areas of economics, mathematics or statistics (T 2290-2291). Second, the recommendations of witness Burkhardt were based entirely on the mechanical results of his model and he "did not exercise . . . [his] own independent judgment . . . in reaching those recommendations" (T 2368). With these two facts in mind, we turn to an examination of Mr. Burkhardt's model.

Staff witness Burkhardt employed a multiple regression model developed from 95 utility companies identified in his Schedule 16 (T 485). It should be noted that Company is not included in the 95 utility companies considered in Schedule 16. Mr. Burkhardt described this model as "not a method of risk measure per se" (T 482), and

differing substantially from third degree stochastic dominance and the capital asset pricing model. Use of the model attempts to measure what investors are willing to pay against what they receive (T 482).

Mr. Burkhardt selected twelve listed variables (T 483-484) and used data for calendar year 1976 respecting the 95 companies (T 481, 2342-2344). The twelve variables do not represent all conceivable explanatory variables, but do include, according to Mr. Burkhardt, "the most widely discussed and readily available" (T 484). The results of Mr. Burkhardt's model led him to believe that only the following six variables were statistically significant (T 485): (1) Book yield; (2) Earnings growth; (3) Bond rating; (4) Regulatory ranking; (5) Stock exchange listing; and (6) Cash coverage of dividends.

This was the third major rate case in less than twelve months in which a "multiple regression model" was used by this witness (T 2307-2308). The distinctions in the use deserve to be noted (T 2307-2315).

First, in Re: Kansas City Power & Light Company, Case No. ER-77-118 (Mo. P.S.C. 1977), the witness used a model developed from 69, rather than 95, companies based upon data from a five-year period ending June 30, 1976, rather than the calendar year 1976 (T 2310-2311). The witness did not remember at first his use of fewer companies and never did recall the period used in the KCPL case (T 2309-2310).

In the KCPL case, the witness began with twelve variables (T 2312). One of the twelve was volatility of historic equity returns, an important variable ignored in this case (T 483-484, 2315; Case No. ER-77-118, at 13). On the other hand, in this case, the stock exchange listing (not an important factor since most major utility stocks are listed) was used as a variable (T 483-485), while it was ignored in the KCPL case (T 2315; Case No. ER-77-118, at 13).

Even more significant, in the KCPL case, only five of the variables proved to be significant in their impact on market/book ratio (T 2312). In the instant case, six were found to be significant (T 485) One might ask were all of the five in the KCPL case found to be significant in the instant case? The answer is no (T 485, 2312-2314).

The very first listed significant variable in the KCPL case was return on common equity which was found insignificant here (T 485, 2312-2313). The stock exchange listing, found significant here (T 485), was not even in the original twelve variables in the KCPL case (T 2315; Case No. ER-77-118, at 13). Cash flow coverage of dividends was not among the significant variables in the KCPL case (T 2313). Thus, we have a situation where three of the six variables in the instant case were discarded or ignored in the KCPL case. They are the bond rating, the stock exchange listing and the cash flow coverage of dividends (T 2312-2314).

Now, it might be thought that this is explained by the difference in the number of companies or perhaps the selection of companies, since the Staff witness did not know whether all of the 69 companies in the KCPL study were included in this study (T 2312), or perhaps the difference in the period covered.

However, these explanations are disputed by the use of the model in Union Electric Company, Case No. ER-77-154 (Mo. P.S.C. 1978). In that case, 95 electric companies were used to develop the model and the same time frame, calendar year 1976, was used (T 2315; Case No. ER-77-154, at 18). However, the Staff witness started with only eleven possible variables, omitting the stock exchange listing as a variable which "survived the cut" in the instant case (T 2314-2315).

Only four of the eleven variables proved to have a significant impact in the Union Electric case (T 2314). The two found significant here, but discarded or ignored there, were the stock exchange listing, ignored in the selection of the eleven, and the cash flow coverage of dividends, a variable found significant in this case (T 2315). The record does not reveal whether the 95 companies in Union Electric are the same 95 companies used in the instant case.

Company submits there was no reasonable explanation offered for these inconsistencies in the development and application of the model by the Staff witness and that the credibility of the result in this case is, thereby destroyed. If there is any validity which can be ascribed to this model, it should be used with the same variables for all, or the differing use explained on a credible basis. With or without this inconsistent approach, any results from the model must naturally be tempered by judgment, which this witness denied using.

We believe it is fair to characterize this methodology as the prior selection of a destination and then selecting a route which permits that destination to be reached. The result was chosen and then the variables were selected and adjusted to be consistent with the chosen result.

In addition to being inconsistent with the use of models in Union Electric and Kansas City Power & Light, supra, Mr. Burkhardt's model, as used in the case at bar, is inapplicable to Company.

The starting point for evaluating any model used for comparative purposes is that the member companies in the model should be comparable to the company under review. Stated simply, you don't compare apples and oranges. This is obviously consistent with the Supreme Court's

mandate in Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944): "the return to the equity owner should be commensurate with return on investment in other enterprises having corresponding risks." Staff witness Burkhardt quoted this passage in his prepared testimony (T 465). However, when considering his model, he ignored this mandate. A short review of Mr. Burkhardt's testimony will demonstrate this contention.

Mr. Burkhardt admitted that his model makes use of ordinary least squares in such a manner as to produce an equation that tends to develop coefficients which are representative of average companies (T 2332). In other words, the model was designed to be a reliable predicto of the individual variables which determine the market to book ratio of companies similar to the average company included in the model. This being the case, it is necessary to compare the characteristics of Company to the characteristics of the companies used in the model. In that the model consisted of 95 of the 110 regulated electric utilities, we will use the industry averages proffered by witness Burkhardt for this analysis (Staff Exhibit 2). Compare the following characteristics of the electric utility industry average with those characteristics of Company (T 2308-2309, 2322, 2386; Staff Exhibit 2, Schedules 18, 19):

	Company	Electric Utility Industry
Equity Ratio	30 %	34.5%
Payout Ratio (1976)	42.7%	67.7%
Bond Yield (1976)	59 %	78 %
Bond Rating	No rating	AA
Stock Dividend	Yes	None

The object of this comparison is to demonstrate that Missouri Public Service Company is not the average electric company. Consequently, a model designed to reflect the variables which determine the market/book value of companies similar to the average company included in the model is not an accurate reflection of the variables which determine the market/book value of a company with such a marked contrast from the average as Company. Although the differences between the characteristics of Company and the members of the model are obvious, a close review of some of those characteristics is warranted.

One of the most significant contrasts between Company and the members of the model is the use of a stock dividend. From 1957 to date, Company has paid a stock dividend (Staff Exhibit 2, Appendix at 10). However, neither Company nor any other company utilizing a stock dividend was included in the model (T 2308-2309). When asked why Rochester Gas & Electric Company was excluded from his model, Mr. Burkhardt stated that the reason for excluding it was because it paid a stock dividend like Company (T 2308). This is the same reason why he excluded Company from the model (T 2333). Mr. Burkhardt conceded that both were excluded because it was simply too difficult for him to measure the value of the stock dividend paid by Company and Rochester Gas & Electric (T 2333).

Another significant variance between Company and the members of the model relates to bond ratings. Mr. Burkhardt's analysis concluded that bond rating was a significant variable in determining the appropriate market/book value (T 485, 490). However, when computing Company's required market/book value, he used a AA bond rating (T 2322). Company's bonds are unrated (T 2322). Mr. Burkhardt was asked why he did not use

the Company's no bond rating. His reply was that when you plug Company's no bond rating into his model that the "model . . . goes to pot" (T 2328). This result reflects the difference between Company's no bond rating and the average AA bond rating of the members of the model (T 2322). The Court should note that even though the designer of the model stated that bond rating is a significant independent variable in determining market/book value and that his "model . . . goes to pot" when Company's no bond rating is plugged into his model, he insists without explanation that the model accurately predicts Company's market/book value.

Company's average cash payout ratio for the years 1967-1976 was 50.7 percent compared with the industry average of 68.9 percent (Staff Exhibit 2, Schedule 18). Mr. Burkhardt's recommended rate of return was based on an assumed payout ratio of 67.5 percent for Company, as opposed to its actual ratio of 42.7 percent for 1976 (T 2347; Staff Exhibit 2, Schedule 17). The Commission had heretofore rejected artificially determined and selected cash payout ratios in Union Electric and Kansas City Power & Light, supra. Company does not argue that the Commission is bound by its previous decisions in this area, as apparently the Commission anticipated (Commission Brief, at 53). Rather, Company contends that such a determination is purely within the managerial discretion of Company. To base a rate of return on an assumed, rather than the actual, anticipated payout ratio, would force Company to choose between confiscatory rates or allowing the Commission to dictate Company's internal discretionary corporate policies. Such a choice flies in the face of the boundaries of regulation established by Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service

Commission of Missouri, 262 U.S. 276, 289, 43 S.Ct. 544, 547 (1923).

Other variables which distinguish Company are its high percentage of residential customers, low industrial base, and its correspondingly low load factor (T 2335-2336). Company has the lowest load factor of the 100 largest electric utilities in the United States (T 2335). A low load factor necessarily creates more difficulty in recouping fixed costs. Consequently, an investment in a company with a low load factor is riskier than an investment in a company with a high load factor. Nevertheless, Mr. Burkhardt did not even include this distinguishing characteristic in his list of twelve variables to see if it was a significant determinant in computing Company's required rate of return (T 2335-2336).

One of the most significant distinguishing characteristics between Company and the electric utility industry is Company's low equity ratio (T 2339-2340). At this point, it would be inappropriate for Company to debate the merits of this policy. However, the fact is that Company has a lower than average equity ratio and that the Staff's analysis concluded that this lower than average equity ratio, accompanied by a higher than average risk factor, is not important in setting a return on equity (T 2339, 2386). Mr. Burkhardt states that investors believe that an electric company is an electric company and that they do not require a higher return for investing in a relatively riskier electric company (T 493). In spite of the rather remarkable results of his model, Mr. Burkhardt, when pressed on cross-examination, conceded that if he were to choose between two companies being equal in all respects except that one was characterized by high risk and the other was characterized by low risk, that he would invest in the latter

(T 2386-2389). In other words, Mr. Burkhardt would not even follow the results of his model. However, he had no qualms about recommending to the Commission that it accept the model's results. This recommendation was made even though the results state that a higher return is not required for an investment in a riskier enterprise which is opposed to all traditional authority, against Mr. Burkhardt's own investor instincts and against all common sense.

The discrepancies between the characteristics of Company and the members of the model were not overlooked by Staff witness Burkhardt; rather, they were purposefully ignored. Mr. Burkhardt summarized the numerous discrepancies stating simply that Company's policies are "entirely" different from other electric utilities (T 495). Although Mr. Burkhardt began his testimony by stating that he was testifying only to determine Company's need, and not to examine the efficiency of Company's management and policy (T 463), he did precisely the opposite.

Mr. Burkhardt's so-called analysis concluded that Company's problem was its stock dividend policy and low payout ratio (T 495). Recall that its stock dividend policy was not tested by the Burkhardt model to determine its significance and that the model found payout ratio to be insignificant (T 483-485, 2339, 2386). In spite of the results of his own model, Mr. Burkhardt concluded that it was necessary for him to go into Company's board room and set a cash payout ratio at 67.5 percent, assume an annual dividend of $1.96 per share, and eliminate Company's long-standing stock dividend (T 2347), which the Commission has approved (T 2348-2349), as required either annually or semi-annually, since 1956!

After recommendng a range with a midpoint of 12.71 percent return

on equity based on assumed earnings per share of $1.96, coupled with an assumed 67.5 percent cash payout ratio, Mr. Burkhardt was asked to consider Company's financial condition and explain how Missouri Public Service Company could possibly achieve those results. Mr. Burkhardt, quite frankly, admitted that he could not tell Company how it could do so (T 2366).

This statement by the author of the model emphasizes the impracticality of his heralded model. The model consumes volumes of data and spews forth a given value. It ignores the realities of this Company's financial condition. This model miserably fails to meet the requirements set forth by the Supreme Court in Hope Natural Gas. Although previously quoted, the following statement by the Court perfectly illustrates the errors of this model: "Elaborate predictions that are at war with realities are of no avail." Lindheimer vs. Illinois Bell Telephone Co., 292 U.S. 151, 164, 54 S.Ct. 658, 663 (1934).

When initially faced with the Staff's presentation, it became apparent to Company that the development and use of the model must be reviewed by someone in the field with sufficient capabilities and experience to evaluate and critique Staff's presentation. For that and other rebuttal purposes, Company employed Eugene F. Brigham, Professor of Finance at the University of Florida, and Director of the Public Utility Research Center at that institution. Dr. Brigham's broad experience, in both the public and private sectors, is indisputable (T 2471-2478). He is the author of the most widely used and best received finance textbook in the country, a textbook used in more than a thousand universities, including Harvard, MIT, Stanford and some 22 universities and colleges in Missouri (T 2473). When questioned extensively about

his compensation, it became clear that three-fourths of that compensation goes to the University of Florida Utility Research Center (T 2603-2604). Dr. Brigham regards himself, and fairly so, as an independent witness (T 2602). A dispassionate reading of his testimony will confirm this.

After reviewing the Staff's regression model, Dr. Brigham recognized the concept as being based upon the work of Professor Myron Gordon (T 2512); however, he criticized Staff's application of the model in three principal areas, as well as some other related areas. The three principal areas of criticism involved the use of 1976 data rather than more recent information, the handling of Company's stock dividend and the treatment of Company's equity ratio (T 2479).

Dr. Brigham conducted a regression study using the most recent available data (T 2520-2521). The results of his study appear in Company Exhibit 33. Dr. Brigham utilized the Staff's model and employed the same procedures (without endorsing them) as did Staff witness Burkhardt, including the same target market/book value of 106 percent (T 2521). Within the confines of the Staff's assumptions and procedures, Dr. Brigham reached a midpoint of 13.42 percent as the required return on equity for Company. Dr. Brigham also conducted identical runs with the model after correcting the target market/book value to 115 percent to accommodate preoffering pressure and issuance expenses (T 2522). The results of these runs indicated a required return on equity of 14.6 percent for Company (T 2522). It should be noted that Dr. Brigham regarded the then recent increase in interest rates and decrease in prices for utility stocks as necessarily requiring still higher estimates of the cost of equity. Had that data been

run in the model, the results would have indicated a required return on equity of more than 14.6 percent (T 2523).

Dr. Brigham made one significant departure from the procedures used by the Staff when he conducted his regression study. That departure was the use of the figures for equity ratio which were excluded by Staff witness Burkhardt. Dr. Brigham included equity ratio in his regression model for two reasons: First, because equity ratio is theoretically significant in determining required rate of return for a company; and second, because the use of the 1978 data indicated that equity ratio was indeed, in fact, significant (T 2522). Dr. Brigham's criticism of the Staff's decision to exclude equity ratio from its regression model will be discussed in more detail later.

The importance of the most recent available data arises out of, among other things, the validity of interest rates used in the cost of capital (T 2520). Staff witness Burkhardt conceded during cross-examination that interest rates had increased substantially in the six months preceding the hearings in this case (T 2303) and that the consensus of the financial community is that interest rates will continue to rise (T 2305). In his direct testimony (T 477), Mr. Burkhardt stated that when interest rates go up, the price of utility stocks will go down. Although he later attempted to explain away this fact by asserting that 1976 interest rates were higher than those in existence in 1977, the significance, notwithstanding today's even higher interest rates and lower utility stock prices, is clearly demonstrated by Dr. Brigham's use of Staff's regression model employing the most recent data available, including a portion of those changes.

Dr. Brigham's second specific criticism of Staff's regression

analysis concerns the treatment of Company's stock dividend (T 2479-2507). Staff witness Burkhardt "treated the company" as though it had a "normal dividend policy consisting of an 'all-cash' dividend payment" (T 487). That assumption led Mr. Burkhardt to assume the unrealistic 67.5 percent cash payout ratio on assumed earnings of $1.96 per share and an assumed dividend of $1.32 per share. Thus, Mr. Burkhardt and the Staff's analysis chose to ignore Company's long-established stock dividend policy. Mr. Burkhardt said he did this because of his conclusions relative to the value of the stock dividend and the information developed in his appendix (T 487). (Reference to Mr. Burkhardt's appendix is to the appendix page number.)

Staff witness Burkhardt developed an equation to place a value upon Company's stock dividend (T 486-487). That equation led Mr. Burkhardt to conclude that Company's 4 percent stock dividend should be valued at .5 percent, or 7.7 cents per share (T 487). This is another one of his conclusions which required Company to engage the services of Dr. Brigham. Dr. Brigham analyzed both the regression model determination of the value of Company's stock dividend and Mr. Burkhardt's assertions and conclusions contained in his appendix. The analysis by Dr. Brigham completely destroys the credibility of the value assigned to the stock dividend by Mr. Burkhardt and together with other evidence, the conclusions found in Mr. Burkhardt's appendix (T 2479-2507).

In pages 15-17 of Staff witness Burkhardt's appendix, he quotes from a number of texts, including one authored by Dr. Brigham. The appendix clearly indicates that Mr. Burkhardt concluded that the use of stock dividends depresses the market price of Company's common stock because income oriented investors, who want to maximize cash dividends,

are not attracted to Company. Dr. Brigham reviewed Mr. Burkhardt's appendix and concluded that, in fact, that appendix shows nothing from which it can be concluded that stock dividends are harmful "to either stockholders or to ratepayers;" rather, the appendix simply consists of "a series of assertions . . . [by Mr. Burkhardt] that stock dividends were bad" (T 2481). Furthermore, Dr. Brigham stated that Value Line (a securities research and survey service) does not recommend that investors in general should avoid Company's common stock; rather, only those investors seeking maximum current income, irrespective of taxation, should avoid Company stock (T 2481).

Dr. Brigham also disagreed with Mr. Burkhardt's interpretation of certain textbooks (T 2481). As one of the authors of those textbooks, Dr. Brigham's view is entitled to great weight. Staff witness Burkhardt interpreted the textbook statements as meaning that stock dividends are not worth as much as retained earnings or cash dividends. Dr. Brigham disagreed with Mr. Burkhardt's conclusions and stated that investors or shareholders are simply indifferent as to whether they receive a 50 cent per share cash dividend, a 50 cent per share stock dividend, or whether 50 cents per share is retained by the Company (T 2481). Contrary to Staff witness Burkhardt's claim that investors are confused by stock dividends, Dr. Brigham stated that investors are not confused by stock dividends and that a stock dividend does not adversely affect the price of the common stock; rather, it is only an accounting entry which, by no means, results in diminution of the book value or market price of the stock (T 2482).

At page 10 of his appendix, Staff witness Burkhardt lists the following four reasons for the use of stock dividends: (1) more funds

can be generated internally; (2) existing shareholders can maintain their respective interest; (3) taxes can be saved; and (4) flotation costs can be reduced. Dr. Brigham concluded that these are reasons for holding down cash dividend payments, but not necessarily the reasons for paying stock dividends (T 2482). In fact, Dr. Brigham stated that each of the four goals specified by Mr. Burkhardt could be accomplished by utilizing a low cash payout ratio with or without a stock dividend (T 2482-82). Dr. Brigham indicated three reasons for using stock dividends. The first is that a stock dividend creates growth in cash dividends (T 2483). Secondly, if an investor needs cash, he can simply sell his stock dividends (T 2483-2484). Finally, a very important advantage to an investor from a company's use of stock dividend is the tax result (T 2484-2489). For instance, there are no tax consequences on a stock dividend until the shares are sold, whereas, in the case of a cash dividend or an automatic dividend reinvestment program, the stockholder pays current taxes on the amount of the cash dividend (T 2484-2485). Even if the stock dividend is sold, it is a capital gains transaction.

Dr. Brigham conducted a survey of New York Stock Exchange companies in 1976 and 1978 (T 2486). That survey indicated a 33 percent increase in the number of companies using a stock dividend (T 2486). It was also noted by Dr. Brigham that only one of those companies, Savannah Electric, was a utility (T 2486). Dr. Brigham also indicated that this increase is due to various companies' desires to serve the interests of their investors who, more and more, want a combination of cash dividends for income, accompanied by the growth in those cash dividends provided by a regular stock dividend (T 2485-2489). Dr. Brigham concluded that a stock dividend policy is actually a superior form of automatic dividend

reinvestment for anyone who pays taxes and, at the same time, is trying to save and get some growth (T 2489).

At page 4 of Mr. Burkhardt's appendix, he cites 1977 data which indicated that Company's market/book value was lower than the average of the other four Missouri electric utilities as evidence in support of his contention that Company's stock dividend policy has adversely affected the price of its common stock. Company Exhibit 29, sponsored by Dr. Brigham, uses March, 1978 data which indicates that Company's market/book value is above the average of the other four electric utilities in Missouri and, in fact, is second of the five. This exhibit illustrates the fallacy in Mr. Burkhardt's contention that stock dividends are harmful or depressive to the market price of Company's common stock (T 2491).

Dr. Brigham offered a convincing example that stock dividends do not adversely affect the value of common stock (T 2493-2495). The example involved Citizen's Utilities Company which has Class A stock, paying only stock dividends, and Class B stock, paying only cash dividends. The Class A stock has always sold at a premium over the Class B stock. The stock dividends have a value that is exactly equal to the value of the cash dividends, so that Class A and Class B stockholders receive the same amount of the Company's total earnings, either in the form of cash dividends or in stock dividends. At the time of the hearing, the Class A stock was selling at a 12.3 percent premium over the Class B stock, and in the most recent Value Line, the Class A was selling at a 17 percent premium over the Class B stock (T 2493-2495; Company Exhibit 30).

Dr. Brigham utilized Company Exhibit 31 to demonstrate the errors

in the analysis used by Staff witness Burkhardt that led to the Staff's conclusion that Company's stock dividend should be given only a nominal value of 7 plus cents per share (T 2498-2506). Case 1 in Company Exhibit 31 portrays Mr. Burkhardt's basic equation which he used to predict the target market/book value for Company (T 2499). Case 2 in Exhibit 31 assumes that there are no errors in the regression coefficient utilized in Case 1 and solves the book yield as Staff witness Burkhardt had done, which revealed a difference of 6.36 percent, which forces the equation to produce the actual market/ book ratio (T 2500). The fallacy with this approach is that Mr. Burkhardt has assumed that there are no errors in his model, when, in fact, Case 1 in Exhibit 31 demonstrates that there are indeed standard errors in these coefficients (T 2500).

Case 3 in Exhibit 31 presents a vivid demonstration of the errors in the analysis of Mr. Burkhardt for which he failed to allow. In Case 3, Dr. Brigham utilized data for Tampa Electric Company and utilized the Staff's regression model (T 2503-2504). The Staff's model yielded a value for Tampa Electric's stock dividend of 1.25 percent (T 2504). The interesting fact to note is that Tampa Electric has not paid a stock dividend (T 2504)! Another example of the error in Staff's model is that Savannah Electric, which does issue a stock dividend, came up with a negative value for that stock dividend (T 2505)!

Dr. Brigham summarized the errors in Staff's regression model by stating that the model actually gathers all of the errors and concentrates them on one variable (T 2503). In other words, Mr. Burkhardt assumed that all of these coefficients were exactly right and then forced everything else into the book yield term, thus yielding a distorted value for Company's stock dividend (T 2503).

Company not only introduced evidence by Dr. Brigham to critique Staff's conclusions with respect to the value of Company's stock dividend; Company also offered affirmative proof as to the value of that stock dividend. Company witness John R. Baker utilized the actual stated value of 4 percent for Company's stock dividend in his DCF analysis (T 382-384). The 4 percent value, which was derived from Company's books, was nowhere successfully attacked. In fact, the value of approximately 4 percent is supported by comparative evidence from the other Missouri electric utilities. For example, while Company's cash dividend yield was approximately 3 percent below the cash dividend yield of the other Missouri electric utilities, Company's recent market/book value was the second highest in Missouri. Consequently, the only explanation for the willingness of investors to purchase and hold Company's common stock is that those investors must perceive substantial value to Company's stock dividend.

Company has made studies from time to time which have always indicated that its shareholders are in agreement with Company's stock dividend policy. The latest survey was made in March, 1978, wherein approximately 90 percent of the shareholders surveyed approved of Company's current stock dividend policy (T 2173). Mr. Baker indicated that any mandated change in Company's stock dividend policy would threaten the loss of a large segment of Company's existing shareholders, would throw a substantial portion of Company's stock on the market, drive the price of Company's stock down and create a serious problem for Company in raising all forms of capital (T 2176-2177). Such a mandated change would constitute the abandonment of a policy developed and used with the Commission's approval for more than 20 years and could only result

in much higher cost of capital, substantially less retained earnings and an extended period of uncertainty coinciding with a period of substantial capital needs (T 2176-2178).

Robert H. Hanson was the only witness from the financial community to testify with respect to Company's stock dividend policy. Mr. Hanson is a Vice President of Merrill Lynch Pierce Fenner & Smith, Inc., and is a member of the Public Utility Department of that firm's investment division (T 2679). As such, Mr. Hanson indicated that he was quite familiar with Company's stock dividend policy and its acceptance by existing and prospective purchasers of its common stock (T 2683). Mr. Hanson indicated that Company's stock dividend policy had served it and its customers very well over the years (T 2683). It was quite obvious to Mr. Hanson, after comparing the market prices and cash dividend yields of other Missouri electric utilities to those of Company, that investors do indeed assign a substantial value to Company's stock dividend policy (T 2684). Mr. Hanson noted the tax advantages (T 2686), the favorable impact on internally generated cash (T 2687), and the contribution to the common equity component of Company's capital structure (T 2687) that have resulted from Company's stock dividend policy.

Mr. Hanson also stated that Company's stock dividend has provided it with a greater cushion or margin of protection against downturns in earnings which could impair a cash dividend policy (T 2688-2690). For example, consider the year 1977. If Company had utilized the standard policy of distributing 70 percent of its available net income for common stock as a cash dividend, the indicated rate for 1977 would have been approximately $1.40 per share (T 2688). However, Company actually

earned only $1.32 per share in 1977 (T 2688). Consequently, investors would have been very uneasy about the probability of Company's ability to continue cash dividends at a level above its actual earnings, all to the detriment of the value of Company's common stock (T 2688). Company avoided these detrimental results by the continued use of its stock dividend policy (T 2688-2689).

Mr. Hanson was not cross-examined by the Staff attorney. When questioned by a Commissioner, Mr. Hanson indicated that he would certainly recommend the continuance by Company of its stock dividend policy (T 2697-2698). Mr. Hanson further clarified the uncertainty left in the record by Staff witness Burkhardt when Mr. Hanson testified that there is no diminution of the relative book value per share after a stock dividend, irrespective of the market value at the time of the stock dividend (T 2699).

Dr. Brigham's third specific criticism of Staff's regression analysis concerns Staff witness Burkhardt's decision to ignore Company's low equity ratio and its corresponding higher risk factor (T 2507-2508). Dr. Brigham pointed out that Staff witness ignored the well-known thesis that security prices and required rates of return are affected by leverage (T 2510). Indeed, regulatory bodies in Missouri and all across the country have long recognized this fact and have adjusted rates of return to account for it (T 2510). Numerous textbooks and hundreds of studies have been undertaken with respect to this thesis and not one has ever disputed the conclusion that <u>a higher rate of return is required for a company with a low equity ratio</u> (T 2511-2517). Even the four textbooks cited by Staff witness Burkhardt in his appendix all agree with the general thesis that <u>lower equity ratios require higher rates of return</u> (T 2511-2512).

Dr. Brigham sponsored Company Exhibit 32 which showed the determinants used by Professor Myron Gordon in a study for the Federal Communications Commission covering an 11-year period (T 2513). The model used by Professor Gordon was similar to that used by Staff witness Burkhardt, with the exception that the Staff's model failed to use logarithms to reduce spurious correlations (T 2513). The conclusion from Professor Gordon's study is that the "signs all indicate that the more leverage the Company has, the lower the market/book ratio will be . . ." (T 2514). Although there is some fluctuation from year to year, such results not from disputes with Professor Gordon's conclusion, but from some multi-collinearity and sampling errors (T 2514). The conclusion is inescapable that there are "very clear relationships" between the cost of equity and the chosen leverage (T 2515).

Another well-known study on the cost of capital, which was conducted by Professor Franco Modigliani and Professor Merton Miller, of the University of Chicago, likewise, "found a strong relationship" between cost of equity and leverage (T 2515-2516). This subject has been extensively studied and everyone, barring Staff witness Burkhardt, has reached the conclusion that a lower equity ratio requires a higher return on equity to compensate the investor for investing in a riskier company (T 2516-2517).

Dr. Brigham presented a statistical explanation for the erroneous conclusion of the model utilized by Staff witness Burkhardt (T 2517-2520). Dr. Brigham concluded that the Staff's error was principally caused by the instability of year-to-year fluctuations in the various parameters used in the model (T 2518). In some years, the equity ratio is shown statistically less significant than other years (T 2518). It

was Dr. Brigham's belief that Mr. Burkhardt's study indicated the correct sign, but the coefficient was too low in relation to its standard error (T 2518). This probably resulted from multi-collinearity, which "simply means that the variables that are used to explain or to predict, in this case, the market/book ratio are correlated among themselves" (T 2518). Such multicollinearity produces incorrect and indeed, invalid results (T 2519).

Recall that Dr. Brigham utilized the Staff's regression model using 1978 data and included the equity ratio data in accordance with the unanimous conclusion of all academic studies in this area (Company Exhibit 33). Staff's model then indicated a required return on equity of 13.5 percent to reach a target market/book ratio of 106 percent, and a required return on equity of 14.6 percent, to reach a more realistic target market/book ratio of 115 percent (T 2522).

Two additional witnesses testified for Company with respect to its relatively low equity ratio. Dr. David A. West, Professor of Finance at the University of Missouri-Columbia, testified with respect to the impact upon the total cost of all forms of capital resulting from Company's low equity ratio (T 2668-2674). Dr. West initiated his testimony by disputing Staff witness Burkhardt's conclusion that investors view all electric companies as virtually the same with respect to risk return characteristics (T 2668). Dr. West then stated that, contrary to Mr. Burkhardt's conclusion, this Company's customers have indeed benefited from Company's low equity ratio policy (T 2669-2672). Dr. West indicated that Company's capital structure "permits a lower total cost of capital" than would be the case with a higher equity ratio and, as a result, Company's "customers have enjoyed a substantial savings over the past decade" (T 2669).

To demonstrate his conclusions, Dr. West prepared Company Exhibits 35 and 36 (T 2669-2670). Company Exhibit 35 compared the average capital structure of Class A and B electric utilities with Company's structure for a ten-year period, between 1968-1977 (T 2670). This exhibit indicated that Company has a lower common equity portion of its capital structure than was the case for the Class A and Class B electric companies in general (T 2670). Company Exhibit 36 quantified the savings that Company derived during that ten-year period (T 2670). This exhibit compares two costs of capital calculations and computes the difference between these two costs of capital and the savings to Company's customers resulting from the lower overall cost of capital. The first cost of capital calculation uses Company's actual capital structure with cost of common equity (14.0 and 14.1 percent), approximating those previously approved for Company by this Commission. The second calculation assumes for Company a hypothetical capital structure which corresponds with the average of the electric utility industry and assumes cost of common equity (12.75 and 13.0 percent), approximating those previously approved by this Commission for other Missouri electric utilities (T 2670). Dr. West's study concluded that even though Company's cost of common equity is somewhat higher than that for other Missouri electric utilities, due to greater risk to Company's common stockholders, the total cost of capital to Company's ratepayers was some 19.2 million dollars lower between 1968-1977 than it would have been had Company actually been in line with the industry average (T 2670-2671). In other words, any increase in the required return on equity due to Company's relatively low equity ratio is more than offset by the savings that Company realizes by the use of less expensive forms of financing for the remaining capital requirements (T 2672).

Dr. West was not cross-examined by Staff attorney. There were no questions on cross-examination by any party with respect to the substance of his testimony. Consequently, the evidence offered by Dr. West with respect to the impact on Company's total cost of equity resulting from its relatively low equity ratic stands unchallenged.

Mr. Hanson, from the financial community, also briefly testified with respect to Company's equity ratio. In response to a question by a Commissioner, Mr. Hanson indicated that he did not recommend any increase in Company's equity ratio at this time because:

> at these levels that, while it is on the low side of the public utility spectrum, this capital structure affords the Company with an opportunity to minimize the revenue requirements associated with its cost of capital and to derive the benefits of the leverage which work for the benefit both of the ratepayers and the investors . . .

(T 2698-2699).

The Federal Energy Regulatory Commission (FERC) recently considered and rejected the use of a regression model to determine a company's return on common equity. In Re: Boston Edison Company, 30 PUR 4th 477, 487 (F.E.R.C. 1979), the FERC stated the following:

> The commission has no doubt that the allowed return on common equity directly affects the price of a utility's common stock. The commission further agrees that it is desirable for the price of a utility's stock to sell at a price at least equal to book value, in order to facilitate additional equity financing when necessary. However, considering the vagaries of the stock market and the sensitivity of stock prices to such unpredictable factors as prevailing economic and market conditions, interest rates, investor confidence, international events, and inflation, it seems clearly beyond the capability of statistical analysis, however sophisticated, to calculate the precise return on common equity which will cause the price of a utility's stock [t sell at or near its per share book value. Moreover, since market conditions and prices are constantly changing, it is likely there exists no single common equity return which would insure parity between price and book value. For this reason and the reasons outlined by the presiding judge, the commission must decline to adopt the proposed statistical model for purposes of determining Edison's return on common equity in this proceeding.

We have assumed that the Commission accepted this model in arriving at its recommended rate of return. In so doing, one also accepts the model's underlying assumptions. Company agrees wholeheartedly with the Commission's statement on page 14 of its initial brief, and page 55 of its current brief that: "Like a computer program, if the presumptions underlying such are sound, then the data should draw sound conclusions . . ." However, as indicated above, the underlying presumptions in this model are absurd. In particular, the payout ratio, based upon fictitious earnings and dividends, and bond rating of AA are ridiculous. So, too, are the Staff's presumptions that Company's stock dividend should be valued at 7 plus cents per share and that Company, with its low equity ratio and relatively high risk factor, requires no higher return on common equity. As such, this model and its results are invalid and have no place in this Company's rate proceeding. The Circuit Court readily observed the defects in this model. As stated in the Court's findings, conclusions and judgment:

> Inasmuch as the 12.7 return on equity approved by respondent [Commission] is nearly twice the approximately 7% return on equity being realized by relator shortly before the Report and Order, which 7% return can hardly be significantly improved by the small increase granted, there is little or no opportunity in reality for relator to reach the approved return on equity, even if it be assumed to be reasonable and compensatory. This, too, is confiscation.

(L.F. 156) In that the Circuit Court found the Commission approved a confiscatory return on equity, the Circuit Court did not err in reversing that portion of the Commission's report and order.

III.C.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE UNLAWFULLY RESULTS IN CONFISCATION OF COMPANY'S PROPERTY

BY TAKING ITS PROPERTY FOR PUBLIC USE WITHOUT JUST COMPENSATION, IN THAT THE COMMISSION FAILED TO INCLUDE AN ATTRITION FACTOR IN COMPUTING COMPANY'S REQUIRED RATE OF RETURN, RESULTING IN RATES THAT DO NOT PROVIDE COMPANY WITH AN OPPORTUNITY TO EARN A JUST AND REASONABLE RETURN ON THE VALUE OF ITS PROPERTY USED IN THE PUBLIC SERVICE.

The Staff's regression model and Company's discounted cash flow (DCF) analysis are designed to determine the rate of return that Company must realize to fairly compensate it for the public use of its private property. As stated by Staff witness Burkhardt, the recommended rate of return is the rate of return that Company must be able to earn to comply with the constitutional requirements of a fair and just rate of return. Consequently, regardless of whose recommended rate of return it adopted, the Commission must authorize a return that will provide Company with an opportunity actually to realize that recommended rate of return.

This leads to the third specific basis for Company's contention that the rate of return authorized by the Commission is confiscatory in that the Commission failed to make an allowance for attrition. Before discussing the Commission's failure to consider attrition, it is necessary to discuss the appropriateness of this issue in a rate case.

As previously stated, in authorizing rates that will give a company an opportunity to earn a fair rate of return, the Commission must exercise "fair and enlightened judgment, having regard to all relevant facts." Bluefield Waterworks, 262 U.S., at 692, 43 S.Ct., at 679. Among those relevant facts is the actual experience of the Company, Smith vs. Illinois Bell Telephone Co., 282 U.S., at 160, 51 S.Ct., at 73, because: "Elaborate calculations which are at war with realities are of no avail." Lindheimer, 292 U.S., at 164, 54 S.Ct., at 663.

Company is mindful of the mandate with respect to a long list of citations. However, in urging this Court to hold that, when supported by competent and substantial evidence, an allowance for attrition is required, Company is presenting a case of first impression in Missouri. Consequently, in order to demonstrate the ample authority in support of its position, Company has attached hereto as Appendix A citations from various jurisdictions in support of this proposition and refers to only selected cases in the following discussion of the use of an attrition allowance in rate proceedings.

During the period of increasing inflation in the 1970's, more and more state ratemaking bodies have authorized an attrition allowance. The most often-cited reasons for allowing an adjustment for attrition are: (1) the rates set for a utility company need to allow it to earn it a fair rate of return for a reasonable period of time in the future; (2) the continued erosion of a public utility's earnings is against public interest insofar as poor earnings require a utility to go into the money market in a disadvantageous position; and (3) the continued inability of a utility to earn a fair rate of return causes new rate cases to follow closely upon the heels of the previous rate increase. Narragansett Electric Company vs. Harsch, 117 R.I. 395, 368 A.2d 1194, 1208-1209, 20 PUR 4th 112, 126 (1977). In Narragansett Electric Company the Supreme Court of Rhode Island took notice of the trend in state regulatory bodies allowing an adjustment for attrition stating that:

> While recognition of erosive trends is a relatively recent development, it is now generally conceded that where such attrition has been clearly demonstrated by a utility company, an adjustment to that company's rate of return is appropriate.

Narragansett Electric Company, 368 A.2d, at 1208, 20 PUR 4th, at 126.

The New York Court of Appeals stated the general rule in this fashion:

> Where there is a great disparity between the predicted rate of return found necessary by the Commission and the return actually earned, a suitable adjustment should be made to reflect the attrition . . . that has taken place. . . . "'Experience'--how much better this is than expert testimony, whether in dealing in history or prophecy." (citation omitted)

New York Telephone Co. vs. Public Service Commission, 29 N.Y.2d 164, 272 N.E.2d 554, 557 (1971).

Some opponents have claimed that an allowance for attrition should not be provided because it is too difficult to quantify. The Florida Public Service Commission specifically rejected this position in a particularly enlightened opinion:

> In authorizing this allowance, we are cognizant of arguments by public counsel that better procedures are necessary in order to measure the future attrition of the company in a meaningful fashion. The quantification of future attrition can be nothing more than informed judgment on the part of the person attempting to predict this occurrence. As a matter of fact, no party has suggested a way or means by which to predict accurately future attrition. However, as long as inflation remains a part of our economy, the phenomenon of attrition will continue to occur. This is an indisputable fact of life. No one questions the fact that attrition (or accretion) occurs and that it affects public utilities, including General Telephone Company. The evidence herein reflects it has occurred for a number of years, and has resulted in General failing to achieve its authorized rate of return. There are no simple answers or solutions to the problem. However, the fact that future attrition is difficult to measure should in no way deter us from attempting to provide some reasonable solution to the historical effects of earnings erosion. (emphasis added)

Re: General Telephone Company of Florida, 19 PUR 4th 227, 234-35 (Fla. P.S.C. 1977).

To arrive at an attrition allowance, one necessarily must use his best estimate as to what the effects of inflation will be during the period of time in which the approved rates will be effective.

> As we have often recognized, an allowance for our best estimate of the effect of rising costs is necessary if the rates we set are realistically to reflect the conditions which the company is expected to face, and to provide a reasonable opportunity of achieving the return we establish as reasonable. Such an allowance is proper even when we place reliance, as we do here, upon forecasted revenues and average fiscal 1977 rate base. (footnotes omitted)

Re: Brooklyn Union Gas Company, 17 PUR 4th 451, 460 (N.Y. P.S.C. 1976). Before the Commission can make an estimate as to the effects of the rising costs of operating the public utility, it is obviously necessary that it have evidence before it upon which to base its judgment. Consequently, it is necessary to review briefly the evidence with respect to attrition that was presented to the Commission.

The Staff and Company offered uncontradicted evidence that attrition had occurred with respect to the previous rates of return authorized by the Commission for this Company (T 388-389; Company Exhibit 1, Section 7, Schedule 2; T 496-497; Staff Exhibit 2, Schedules 21, 22). Staff witness Burkhardt pointed out the following five principal factors that contribute to attrition: (1) declines in kilowatt-hour sales growth; (2) new plant additions; (3) inflation; (4) increases in fixed capital costs; and (5) operational difficulties with generating plant (T 497-498). Of these five factors, the witness indicated that declines in kilowatt-hour sales growth is the most significant determinant of attrition for many electric companies (T 498). He further indicated that he saw no indication that these factors would not continue in the future (T 498-499). Furthermore, the Staff witness stated that

his model for determining the rate of return only considered the additional costs related for new fixed charges on capital (T 499). Consequently, his model would not account for attrition resulting from the other four factors.

This short review of the evidence demonstrates that there was uncontradicted evidence that attrition has existed with respect to the rate authorized by this Commission for Company in its five most recent cases; that the factors contributing to the attrition existed at the time of the hearing; that the economic environment that produced these factors would most likely persist in the future; and that, therefore, the Commission should set forth a specific allowance to offset the effects of attrition. The Commission's report and order failed to mention attrition. Consequently, one can only assume that the Commission's order did not make an allowance for attrition.

Company realizes that the Commission has broad discretion in setting rates. However, as previously mentioned, the Supreme Court has set limits on that discretion. In South Central Bell Telephone Company vs. Tennessee Public Service Commission, 579 SW2d 429, 31 PUR 4th 172 (Tenn. App. 1979), the Court of Appeals reviewed the decision by the Tennessee Public Service Commission, wherein the Commission ignored uncontroverted evidence with respect to probable increases in certain expenses and investments during the effective period of its rate order. Therein, the court stated:

> While it is true that the Commission, utilizing its own special expertise, may disregard some uncontroverted expert testimony, it is fundamental that the Commission may not arbitrarily and unreasonably disregard uncontradicted testimony. That is, if uncontradicted testimony is to be disregarded, a valid reason for so doing should be stated. (emphasis added)

South Central Bell Telephone Company, 579 SW2d, at 436, 31 PUR 4th, at

178. In the case at bar, the Commission had before it uncontroverted evidence as to Company's history of attrition and that it was most probable that Company would continue to experience attrition. Yet, the Commission did not even see fit to address the issue of attrition in its report and order. As stated by the Wisconsin Public Service Commission:

> Under these circumstances it is both necessary and reasonable and just that an attrition allowance be included in electric utility revenue requirement for this proceeding so as to afford applicant a truly reasonable opportunity to earn the rate of return authorized here.

Re: Wisconsin Michigan Power Company, 15 PUR 4th 488, 495-496 (Wis. P.S.C. 1976).

The Commission's failure to make an attrition allowance for Company deprives Company of any reasonable opportunity to earn a fair rate of return. This action of the Commission effectively approves confiscatory rates which amount to public taking of private property without just compensation. Even if there were some remote chance that Company could actually earn the authorized rate of return, the rates set by the Commission without considering attrition are confiscatory. As stated by Justice Cardozo in West Ohio Gas Company vs. Public Utilities Commission, 294 U.S. 79, 83, 55 S.Ct. 324, 325 (1935), "Present confiscation is not atoned for by merely holding out the hope of a better life to come." (emphasis added)

In that the portion of the Commission's report and order dealing with the rate of return issue totally ignores the uncontroverted evidence with respect to attrition, that order authorizes confiscatory rates which deprive Company of its private property without just compensation. Consequently, the Circuit Court did not err in reversing that portion of the Commission's report and order.

IV.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE ISSUE OF COST OF MONEY/RATE OF RETURN BECAUSE THE PORTION OF THE REPORT AND ORDER ON THAT ISSUE IS UNREASONABLE IN THAT SUCH FINDINGS AS WERE MADE BY THE COMMISSION ARE NOT SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE UPON THE WHOLE RECORD IN THAT:

(A) THE COMMISSION DID NOT CONSIDER PREOFFERING PRESSURE IN ESTABLISHING THE TARGET MARKET/BOOK VALUE;

(B) THE COMMISSION MAY HAVE RELIED (ALTHOUGH IT DOES NOT SO STATE) UPON A MECHANICAL STATISTICAL MODEL THAT WAS DEFECTIVE IN SEVERAL RESPECTS; AND

(C) THE COMMISSION DID NOT MAKE AN ALLOWANCE FOR ATTRITION.

Article V, §18 of the Missouri Constitution, and §386.510, RSMo 1978, authorize a reviewing court to reverse any order of the Public Service Commission that is not reasonable. State ex rel. Utility Consumers Council of Missouri, Inc. vs. Public Service Commission, 585 S.W.2d 41, 47 (Mo. en banc 1979); State ex rel. Ozark Electric Cooperative, vs. Public Service Commission, 527 S.W.2d 390, 392 (Mo. App., D.K.C. 1975). Whether the Commission's report and order was reasonable turns upon the determination of "whether it is supported by the competent and substantial evidence on the whole record." State ex rel. Ozark Electric Cooperative, 527 S.W.2d, at 392. "Sometimes it is stated that the court is to determine whether the order is arbitrary or capricious or against the overwhelming weight of the evidence." State ex rel. Kansas City Transit, Inc. vs. Public Service Commission, 406 S.W.2d 5, 11-12 (Mo. en banc 1966).

Company contends that the portion of the Commission's report and order pertaining to rate of return is unreasonable in that it was arbitrary, capricious and against the overwhelming weight of the evidence. More particularly, that portion of the report and order is

unreasonable, because: (1) the Commission failed to consider preoffering pressure in establishing the target market/book value; (2) the Commission may have relied upon a mechanical statistical model that was defective in several respects; and (3) the Commission failed to make an allowance for attrition.

The Company's first contention with respect to the unreasonableness of this portion of the report and order concerns the Commission's failure to consider preoffering pressure in establishing the target market/ book value for Company's stock. As previously stated, the target market/book price is the minimum price at which Company must be able to sell new issuances of common stock and, after paying all associated expenses, actually realize book value for the stock. The target market/ book value or price is generally expressed as a percentage of the book value, e.g. 106 percent book value. The goal of realizing book value for the sale of Company's common stock is to prevent the new issuance from diluting the value of the stock held by existing stockholders.

There are two recognized independent variables that determine market/book price: flotation costs and preoffering pressure (T 2523-2524). Flotation costs are those expenses directly associated with the new issuance of common stock. This includes brokers' fees, attorneys' fees, printing expenses, etc. Preoffering pressure is a phenomenon that occurs in the market when there is an existing supply of a commodity, such as common stock, and that supply is increased by a new offering without a corresponding increase in obvious buyers. When the supply increases, yet the demand does not increase, the price of the commodity is expected to drop.

Staff and Company witnesses acknowledged the existence of preoffering pressure (T 2296, 2523, 2702-2705; Company Exhibit 37). Staff

witness Burkhardt stated that in the past, when using a discounted cash flow (DCF) analysis that he used a "lump 10 percent" margin that was added to the market price to compensate for both preoffering pressure and flotation costs (T 2295, 2297). Company witness Baker demonstrated in Company Exhibit 37 that during the Company's last preoffering period (that period between the date of the announcement of the offering and the date of the actual offering), the market price of Company's common stock declined 8.70 percent as compared with a decline of 1.51 percent in the Standard & Poor's Utility Index. This differential in excess of 7 percent is quantifiable preoffering pressure for Company's common stock. Company witness Dr. Eugene F. Brigham stated that "market pressure does exist" (T 2523) and that both preoffering pressure and flotation costs must be incorporated into the target market/book price (T 2523-2524).

The Commission's report and order concludes that the target market/book price for Company should be 106 percent of book value (L.F. 15). As previously indicated, the findings of fact in that report and order do not reveal the basic facts or reasoning upon which the Commission based its conclusion that the target market/book price should be 106 percent of book value. However, the record in this case does establish that: (1) Staff witness Burkhardt recommended a target market/book value of 106 percent book price (T 473); (2) Staff witness Burkhardt recognized the existence of preoffering pressure (T 2296); (3) Staff witness Burkhardt did not make any study to determine the existence of, or quantify the amount of, preoffering pressure with respect to Company's prior stock issuances (T 2297); and (4) Staff witness Burkhardt's recommendation of a target market/book price of 106 percent of book value did not include any allowance for preoffering pressure (T 2295).

The inevitable conclusion is that although the Commission heard uncontradicted evidence as to the existence of quantifiable preoffering pressure with respect to Company's most recent stock issue, the Commission failed to make any allowance for that pressure in setting the target market/book price at 106 percent book value. Such action on the part of the Commission is unreasonable in that the same is arbitrary, capricious and once again, not only against the great weight of the evidence, but it is also against the uncontradicted evidence on this issue. Consequently, the Circuit Court did not err in reversing this portion of the Commission's report and order.

Company's second contention with respect to the unreasonableness of this portion of the Commission's report and order concerns the method adopted by the Commission in determining the appropriate rate of return for Company. The evidence relevant to this issue was set forth in much detail in Point III.B, supra. Repetition of that discussion is unwarranted. However, Company must recap a few basic points:

(1) Staff witness Burkhardt used a mechanical model that was allegedly designed to predict accurately the factors that affect the market/book value of average companies in the electric utility industry;

(2) Because of Company's low equity ratio, stock dividend and other distinguishing characteristics, it is not an average company within the electric utility industry. Staff witness Burkhardt ignored these significant characteristics of Company;

(3) Staff witness Burkhardt utilized certain assumptions with respect to the value of Company's stock dividend because he claimed that the actual value of those dividends was too difficult for him to determine. These assumptions included a fictitious payout ratio, a fictitious earnings level and a fictitious cash dividend;

(4) Staff witness Burkhardt further condeded that his recommendations were based purely upon his mechanical model and that he did not utilize independent judgment in reaching his recommendations;

(5) The Commission adopted the approximate midpoint within the range of the recommended rates of return suggested by Staff witness Burkhardt; therefore, it may be concluded that the Commission adopted the Staff's mechanical model and all of the faults inherent therein.

Company fully realizes that the method used to determine the appropriate rate of return is not in and of itself determinative of the issue of reasonableness. However, in this case, the result, as well as the method, are clearly unreasonable. The Circuit Court indicated that shortly before the Commission's report and order was issued, Company was actually realizing a return on equity of approximately 7 percent (L.F. 156). The Circuit Court noted that the authorized return on equity of 12.7 percent allowed such a small increase, that it would be absurd for any reasonable person to believe that such a small increase would provide Company with a reasonable opportunity actually to earn a reasonable rate of return (L.F. 156).

Company earnestly contends that if there were ever a case that fits the dictates of the Supreme Court in Lindheimer, 292 U.S. 151, 164, 54 S.Ct. 658, 663, wherein the Court stated: "Elaborate calculations which are at war with realities are of no avail," this is the case. Through its discussion of the evidence in Point III.B, supra, Company has pointed out the numerous flaws in the model employed by the Staff, which apparently became the basis for the Commission's recommended rate of return on equity for Company in the Commission's report and order in the case at bar. The Commission's utilization of that

model (if such was the case) was erroneous because the same was not supported by the competent and substantial evidence upon the record as a whole. Consequently, the Circuit Court did not err in overruling this portion of the Commission's report and order.

Company's third attack on the reasonableness of the Commission's findings with respect to the rate of return concerns the Commission's failure to make an allowance for attrition. The Staff and Company offered uncontradicted evidence that attrition has occurred with respect to the previous rates of return authorized by the Commission for this Company (T 388-389; Company Exhibit 1, Section 7, Schedule 2; T 496-497; Staff Exhibit 2, Schedules 21, 22). The Staff's witness pointed out the following five principal factors that contribute to attrition: (1) declines in kilowatt-hour sales growth; (2) new plant additions; (3) inflation; (4) increases in fixed capital cost; and (5) operational difficulties with generating plant (T 497-498). Of these five factors, the witness indicated that declines in kilowatt-hour sales growth is the most significant determinant of attrition for many electric companies (T 498). He further indicated that he saw no indication that these factors would not continue in the future (T 498-499). Furthermore, the Staff witness stated that his model for determining the rate of return only considered the additional cost related to new fixed charges on capital (T 499). Consequently, his model would not account for attrition resulting from the other four factors.

Both Staff and Company witnesses recommended an attrition allowance (T 387-389; Company Exhibit 1, Section 7, Schedule 6; T 499). Staff's witness recommended that the Commission specifically set forth the approved attrition allowance if, during the past years, as both

Company and Staff exhibits demonstrated, Company has been unable to earn the return authorized by the Commission (T 499). As stated by Staff witness Burkhardt: "I am recommending that the Commission allow Mo Pub rates which will produce a return on equity no higher than 12.71 percent" (emphasis added) (T 499).

Company's witness testified that over the past five years Company has suffered on the average a 20 percent shortfall of the authorized return because of attrition (T 388; Company Exhibit 1, Section 7, Schedule 2). Consequently, he recommended a modest attrition allowance of .28 percent be added to the rate of return on original cost net rate base (T 387-389; Company Exhibit 1, Section 7, Schedule 6).

This short review of the evidence demonstrates that there was uncontradicted evidence that attrition has existed with respect to the rates authorized by this Commission for Company in its five most recent cases; that the factors contributing to the attrition existed at the time of the hearing; that the economic environment that produced these factors would most likely persist in the future; and that, therefore, the Commission should set forth a specific allowance to offset the effects of attrition. The Commission's report and order failed to set forth a specific allowance for attrition or make any reference to it whatsoever. Consequently, the Court can only assume that the Commission's order did not make an allowance for attrition. The Commission's failure to allow an attrition factor was, obviously, unreasonable in that it was arbitrary, capricious and against all of the uncontradicted evidence on this issue. Consequently, the Circuit Court did not err in reversing this portion of the Commission's report and order.

V.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER IN THAT:

(A) THE COMMISSION ERRONEOUSLY AUTHORIZED A CUSTOMER USAGE ANNUALIZATION BASED UPON MISMATCHED EXPENSES COMPUTED ON AN OCTOBER 31, 1977 YEAR-END BASIS WITH REVENUES COMPUTED ON A JUNE 30, 1978 YEAR-END BASIS; AND

(B) THE COMMISSION DECREASED COMPANY'S DEPRECIATION RESERVE BASED ON A RESERVE FIGURE AT DECEMBER 31, 1978, THAT WAS MISMATCHED WITH A PLANT FIGURE FOR JUNE 30, 1978, THEREBY ERRONEOUSLY ASSUMING CONSTANT PLANT IN SERVICE FOR COMPANY.

The Commission erroneously concluded that a customer usage annualization was necessary to reflect increased usage per customer in the Company's service territory (L.F. 22-23). The Circuit Court of Cole County, Missouri, reversed that determination since it was not supported by competent and substantial evidence and was totally inconsistent with the position taken by the Commission with regard to the same issue in the gas case (L.F. 157). Additionally, it was inconsistent with the implicit conclusion respecting the depreciation reserve issue which the Staff premised upon the foundation that no additions to plant would be made during the first year of the new rates. The decision of the Circuit Court should be sustained on this issue (L.F. 157).

The Commission's original decision was premised upon allegations that Company had experienced annual growth in use per customer in the past ten years. This, however, was never substantiated with regard to the forthcoming year in which the rates would be in effect. The Commission apparently accepted the evidence of growth in revenues, but rejected the evidence of increased expense per customer which had occurred at the same time. In essence, once again, the Commission

simply approved the Staff's adjustment having the effect of increasing revenues while it denied or ignored the Company's evidence regarding the issue of additional expenses necessary to obtain those revenues.

The Commission's own witness admitted that none of the exhibits of the Public Counsel and the Commission Staff reflected any increase in costs associated with new customers other than fuel costs (T 1763).

Obviously, the costs associated with additional capital investment of Company, the administrative costs of serving "new growth," if in fact there is any substantial new growth, which was never proved, should have been taken into consideration and it was for this reason, among others, that the Circuit Court of Cole County reversed the Commission's decision.

As properly testified to by Company witness, in order for the adjustment to be correct, the exhibits must reflect cost items such as materials and supplies, transportation, contract maintenance, production budget maintenance expenses, increased number of employees and other administrative costs (T 1786-1787).

All of the expenses, with the exception of fuel expense, were closed out on an October 31, 1977 year-end basis, and, therefore, did not match the increased revenues the Public Counsel and Commission Staff proposed to be obtained through June 30, 1978. The Commission should have recognized this mismatch, but it did not, and, thus, the court reversed the Commission's decision.

When the Commission makes an adjustment which increases revenues, the resulting effect is to decrease the amounts of money (i.e. revenues) that will be obtained in the new rate structure approved by the

Commission. Therefore, herein, when we speak of an adjustment by the Staff or Public Counsel, which has the effect of increasing revenues in trying to arrive at the year-ended test year basis, we are, in effect, speaking of a reduction in rates to be authorized in a future period.

If the adjustment proposed by Staff correctly contemplated an increase in resulting expenses related to any increase in customer usage revenues, it would result in a projected or budgeted test year concept. The Commission has not utilized such a projected or budgeted test year concept in this proceeding and to allow the Commission's decision on the issue of customer usage increase to stand would be to allow a budgeted or projected test year concept to the detriment of the Company while disallowing a budgeted or projected test year concept to its favor, or, in simplest terms, mismatch revenues and expenses.

The Commission's decision was inapposite to the dictates of Missouri ex rel. Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri, 262 U.S. 276, 287-288, 43 S.Ct. 544, 546 (1923), which stated that:

> It is impossible to ascertain what will amount to a fair return upon properties devoted to public service, without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values, made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded, such a forecast becomes impossible. (emphasis added)

Even if there were any credibility related to the Staff's adjustment, the Commission, nevertheless, would have erred because it authorized the adjustment to reflect increased revenues for customer usage in the electric proceeding, but absolutely denied the same adjustment in the gas proceeding. Its determination in the latter regard was

premised upon the fact that the adjustment was too speculative and incapable of ascertainment. Nevertheless, it somehow overcame that objection with regard to the adjustment requested by Public Counsel and Staff. This, again, is one of the paramount reasons that the Circuit Court of Cole County, Missouri, reversed the decision of the Commission on this issue.

For these reasons, this Court should sustain the Circuit Court of Cole County, Missouri, with respect to customer usage annualization in the electric case.

The Staff urged that Company's depreciation reserve should be the sum of the June 30, 1978 level and one-half of one year's depreciation expense annualized for plant in service at June 30, 1978 (Joint Exhibit 1, page 6). The Commission adopted Staff's adjustment (L.F. 19-20). However, the Circuit Court of Cole County, Missouri, rightfully reversed the decision of the Commission since to allow the same would be to insure that inadequate rates would be in effect which would disallow the Company's recovery of actual depreciation expenses incurred (L.F. 157).

The Staff's method would have the effect of decreasing the depreciation reserve without allowing rates for an offsetting increase in depreciation expense. The whole concept of the Staff's adjustment was premised upon a static, nonincreasing level of plant in the year in which the rates were in effect for Company (T 659).

In the context of a rate case, there is usually an attempt, as was the case before the Commission in this matter, to match, on a year-ended basis, the plant and cost of service items along with revenues. Therefore, expenses are year-ended, including depreciation expense, in

order to arrive at a proper net income in a rate case. The rate base (i.e. plant in service) is offset by a reserve for depreciation that is represented by collected depreciation expense (T 648).

The investor earns a return on his investment by virtue of the ratepayer returning the dollars to the investor through depreciation expense. These collected dollars from the ratepayer are offset against the investor's investment so that he earns only on what he has invested (T 648).

The history of Company has shown a continuous increase in plant in service and a continuous investment of dollars collected through depreciation expense in that ever increasing plant in service (T 650). As a matter of history, plant has increased far faster than has the depreciation reserve (T 650).

The Staff, although conceding that its whole adjustment was premised upon a static, nonincreasing plant, nevertheless, added an additional $4,000,000 to the reserve which has the effect of mismatching a reserve figure at December 31, 1978, to that of a plant figure at June 30, 1978.

The Staff's own witness conceded that the depreciation expense which Staff proposed in the case is that expense which Company would incur in the year after the tax year, assuming that the plant in service remained constant (T 658-659).

The entire basis of Staff's position is that it does require a predicate of a static plant in service so that the Staff then makes the additional assumption that the average amount of depreciation can be arrived at by halving the annualized depreciation expense to the reserve. Never, throughout the history of Company, has there been a

static, nonincreasing plant. Always the plant has increased dramatically from year to year in order to provide service to the customers of Company.

The Staff witness concedes that he has computed depreciation expense on the level of plant as of June 30, 1978, and then taken one-half year's depreciation premised upon the fact that these rates are made for a year's period which would extend to June 30, 1979 (T 667-668). This, in effect, shifts from a year-end June 30, 1978 rate base determination to an average rate base concept ending June 30, 1979 (T 668). The Staff did not do this on any other rate base item (T 671).

In questioning by Commissioner Jones at the hearings before the Commission, Staff witness Dittmer conceded that if Company reinvested dollars received through the depreciation mechanism, this would infer necessarily an increasing rate base or amount of plant in service (T 673). This absolutely defies and contradicts the premise of Staff's adjustment which is based upon the static, nonincreasing level of plant in service. The Staff witness had no doubt that the plant in service would increase after June 30, 1978 (T 674). In fact, Staff witness conceded that the additions to plant in the forthcoming year would approximate $18,000,000 (T 679-680).

If the theory proposed by Staff were at all accurate, it would assume that increased revenues would offset any increase in operating expenses and inflation and, thus, conclude that there would be absolutely no reason for a company to come in before the Commission requesting an increase in rates. Obviously, this has been totally disproved and continues to be disproved by repeated requests for rate increase

by Company (and all other companies under the jurisdiction of the Commission).

All Company contended, successfully so in the Circuit Court of Cole County, Missouri, was that the depreciation reserve should match the plant in service at June 30, 1978.

Staff, by increasing the electric depreciation reserve by the uncollected amount of $4,444,829, as shown on Line 4, Column 3, Appendix A of Joint Exhibit 1, and the gas depreciation reserve by $302,672, as shown on Line 29, Column 3, Appendix A of Joint Exhibit 1, has completely mismatched the depreciation reserve and plant in service and utilized a depreciation reserve figure which would compare to plant in service as of December 31, 1978, rather than June 30, 1978. The net effect of such an adjustment on depreciation reserve would be to forecast an entire year's depreciation reserve beyond the time the plant in service was allowed by the Commission. Recognizing this mismatch, the Circuit Court of Cole County, Missouri, correctly reversed the Commission's determination in this regard.

If Staff's position were upheld, and taking into consideration continuous addition of plant in service of the Company (as conceded by Staff), then the depreciation expense of Company would also increase without the rates to cover the increase due to the reduction in depreciation reserve allowance.

To this counsel's knowledge, this position was argued only on one other occasion in Re: Kansas City Power & Light Company, Case No. ER-77-118, at 35-37 (Mo. P.S.C. 1977), at which time the Commission rejected Staff's adjustment: "Since Company will be adding Plant-in-Service during the coming year, the Commission will not accept Staff's

adjustments related to this issue." Kansas City Power & Light Company, supra, at 37.

There is absolutely no distinction between Staff's adjustment in Kansas City Power & Light Company, and the adjustment accepted in this proceeding. Obviously, the Commission is mandated to treat all parties before it in a uniform, similar and equal manner. Sam vs. St. Louis & M.R. Co., 174 Mo. 53, 73 S.W. 686 (1903). In that case, the court held that where there are two concerns engaged in precisely the same business and both conducting it in the same manner, a statute or policy which would undertake to impose a liability on one and not on the other cannot be sustained.

An excellent example of the fallacy of Staff's adjustment on depreciation reserve is contained in the dissent of Commissioner Jones on pages 5, 6 and 7 (L.F. 38-40). The example utilized by Commissioner Jones clearly illustrates the mechanical fallacy of Staff's adjustment and the Commission's decision on this issue.

The Circuit Court of Cole County, Missouri, correctly reversed the tortured decision of the Commission on the issue of depreciation reserve.

If the Commission were allowed to set rates which did not compensate Company for expenses actually incurred, it would be capable, as found by the Circuit Court of Cole County, Missouri, of perpetuating a confiscation of Company's property without due process of law in contradiction of the dictates of the touchstone case of Federal Power Commission vs. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281 (1944), which requires rates entitling a just and reasonable return on the

fair value of the utility's property used in the public service.

For these reasons, the decision of the Circuit Court of Cole County, Missouri, is correct and should be sustained respecting the issue of depreciation reserve.

VI.

THE CIRCUIT COURT DID NOT ERR IN REVERSING THE PUBLIC SERVICE COMMISSION'S REPORT AND ORDER WITH RESPECT TO THE FUEL ADJUSTMENT CLAUSE ISSUE BECAUSE THAT PORTION OF THE REPORT AND ORDER IS UNLAWFUL IN THAT THE COMMISSION'S OFFSET AGAINST FUTURE REVENUE REQUIREMENTS BASED ON THE ERRONEOUS ASSUMPTION THAT COMPANY HAD RECEIVED OVER-COLLECTIONS THROUGH THE USE OF THE FUEL ADJUSTMENT CLAUSE CONSTITUTES CONFISCATION OF COMPANY'S PROPERTY THROUGH RETROACTIVE RATEMAKING.

The Staff, during the course of hearings before the Commission, argued that Company had overcollected certain fuel adjustment surcharges from its customers. Company maintained, and does to this date, that there were no overcollections and that the fuel adjustment clause used by Company was in exact accordance with the previous orders of the Commission regarding fuel adjustment.

The fuel adjustment clause is filed as a separate tariff on each occasion that Company files its general tariffs with the Commission. Thus, it is approved by the Commission, or left to go into operation by law, in accordance with the statutes regulating Company.

The Commission unlawfully ordered an offset for what it construed to be overcollected fuel adjustment revenues at the Commission level (L.F. 23-24). This was done by the Commission even though the Commission had previously approved the tariff filed and the actual manner and calculations utilized by Company in collecting the fuel adjustment revenues pursuant to the fuel adjustment clause.

The Circuit Court of Cole County, Missouri, correctly reversed the Commission in this regard since the Commission's actions amounted to retroactive ratemaking (L.F. 158).

The action of the Commission is no different than if Company were to come back in after having previously had its tariffs approved and

maintain that previous calculations by Staff were in error and, thus, it should retroactively increase any expense allowance or any rate base allowance and have that added to its new rates. This is not done in this state or any other state because it would constitute retroactive ratemaking. State ex rel. Utility Consumers Council of Missouri, Inc. vs. Public Service Commission, 585 S.W.2d 41, 58 (Mo. en banc 1979).

Company, in calculating its fuel adjustment clause in strict conformity to the fuel adjustment order of the Commission in Case No. 17,730, followed the guidelines as shown on Company Exhibits 11 and 12 for computing the fuel adjustment clause base. Staff, by contrast, although the fuel adjustment order does not so direct, computed the fuel adjustment clause base by deducting the kilowatt-hour attributable interchange sales and nonjurisdictional sales. Staff witness conceded this (T 1276-1277).

The pertinent parts of the fuel adjustment order, as found in Company Exhibit 11, are set forth on pages 10 and 11 of the dissent of Commissioner Jones (L.F. 43-44).

As stated by Commissioner Jones, it is somewhat preposterous to assume that Company overcharged its customers in 1977 when the Commission found that it earned 8.75 percent on its book equity during that year, despite the fact that the Commission had found that Company should earn 14.0 percent on equity. Obviously, an equity return of 8.75 percent indicates that Company undercollected from its customers during 1977 (L.F. 43).

To follow the Commission's decision would result in a retroactive confiscation of Company's property. A similar conclusion of confiscation was reached in the case of Board of Public Utility Com'rs vs. New York

Telephone Co., 271 U.S. 23, 46 S.Ct. 363 (1926), where the Commissioners attempted to offset what they believed was a previous overcharge against the rates authorized in the immediate case. The Commissioners had disallowed a proposed rate increase, stating that any deficiencies should be applied against the overcharge in the depreciation account until the overcharge was gone. The Court explained that the Commissioners had acknowledged that a rate of return below 7.53 percent was less than a fair return. Company was experiencing a rate of return below that. The Court stated that since the customers of the utility do not acquire any interest in the utility's property by paying rates, but are merely compensating the utility for its services, their payments are not contributions to depreciation or other operating expenses or the capital of Company. Consequently, any past profits of Company cannot be used to sustain confiscatory rates for the future. As stated by the Court, "Profits of the past cannot be used to sustain confiscatory rates for the future." New York Telephone Co., 271 U.S., at 32, 46 S.Ct., at 366.

This case reiterates that any particular issue, item of expense, rate base item or other peculiar issue analyzed in a previous rate case cannot later be found to be subject to some retroactive error. Neither the Commission nor Company can go back upon its previous analyses, determine an error either to Company's detriment or favor, and, thus, prospectively eradicate that error by setting rates in the immediate case which would "un-do" the error. State ex rel. Utility Consumers Council of Missouri vs. Public Service Commission, 585 S.W.2d 41, 58 (Mo. en banc 1979). This is not to say there was an error committed in this regard, as the position is well expressed in the dissent of

Commissioner Jones which illustrates that Company's interpretation was, in the least, as accurate as that of the Commission. The center of this controversy revolves around the issue: whether the Commission can retroactively alter legally and lawfully filed tariffs by making adjustments in prospective rates. The Circuit Court correctly concluded that it cannot, and this Court should sustain the position of the Circuit Court of Cole County, Missouri.

REPLY BRIEF

It is necessary to reply to the assertions made by Staff in its brief regarding the issue of tax normalization. Without attempting to repeat or reiterate what has been previously said in Company's appellant's brief on this issue, certain matters need to be set forth.

As stated in both briefs filed before this Court, the Commission previously authorized full normalization of tax timing differences in Company's previous case in 1976. The premises utilized by the Commission in allowing full tax normalization at that juncture were inadequate cash flow and inadequate interest coverage of Company.

A comparison of the historical features of cash flow and interest coverage, comparing 1977 (the historical test year used in this proceeding) to the same elements in the 1976 case, reveals that Company's financial plight was much more severe in 1977. Nevertheless, the Commission chose not to allow full tax normalization and injected a new policy and "artifice" standard for determination of the issue. In essence, the Commission in this case indicated that the standard was to be arrived at by comparing the internally generated funds calculation to the utility industry national standards. Obviously, as can be seen by a perusal of the financial makeup and especially the information as recited hereinbefore with regard to rate of return issues, Company is quite distinguishable from the rest of the utility industry. To thus interject the new standard, rather than to maintain the policy of the Commission in determining this issue based upon interest coverage and cash flow necessities, is an unwarranted, unreasonable deviation in utility regulation.

This very issue was discussed in the case of Greater Boston Television Corp. vs. F.C.C., 444 F.2d 841, 852 (D.C. Cir. 1970), wherein the court stated:

> An agency's view of what is in the public interest may change, either with or without a change in circumstances. But an agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored, and if an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute.

That is exactly what has occurred in this instance. The Commission compared the criteria that it had used before and found that the comparison was not to Staff's advantage and, thus, simply abandoned that premise for originally granting tax normalization and interjected instead an artificial premise in an attempt to rationalize its final conclusion.

Obviously, throughout the years, Company makes a constant attempt to pattern its bookkeeping, accounting and actions, where possible, in accordance with the avowed policies set previously by the Commission. If the Commission is going to ignore and, without an announcement of the same, shift its policies every time Company is before it in a rate proceeding, it is going to become intolerably difficult to make any valid comparisons of financial data and even more difficult to arrive at a consistent basis for setting rates.

As a result of the Commission's ignoring the facts and data before it, constituting the only valid evidence upon this issue, and, as a further result of the Commission's unreasonable determination in contradiction of the facts and evidence before it, Company requests this Court to reverse the position of the Commission and the Circuit Court of Cole County, Missouri, on the issue of normalization of taxes.

Conclusion

For the reasons herein stated, Company respectfully requests this Court to reach the merits of these appeals, and to affirm those portions of the judgment of the Circuit Court of Cole County that reversed the portions of the Commission's report and order concerning the issues of cost of money/rate of return, customer usage annualization, depreciation reserve, and a fuel adjustment clause offset. Company also requests this Court to reverse that portion of the Circuit Court's judgment that affirmed the portion of the Commission's report and order concerning the issue of income tax normalization.

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APPENDIX A

In addition to those cited in the text of Point III.C, supra, the following courts and commissions have authorized attrition allowances or compensated companies for the effects of attrition:

Re: Arizona Public Service Co., 20 PUR 4th 253, 262 (Ariz. Corp. Comm'n. 1977) (Attrition allowance of 4% approved).

Re: Mountain States Telephone & Telegraph Co., 7 PUR 3d 115, 119-122 (Ariz. Corp. Comm'n. 1954).

Re: Southern California Edison Co., 21 PUR 3d 15, 30-31 (Cal. P.U.C. 1957) (.12% trend allowance granted).

Re: Public Service Co. of Colorado, 34 PUR 3d 186, 216-218 (Colo. P.U.C. 1960) (Attrition allowance of .2% approved).

Re: Georgia Power Co., 30 PUR th 409, 420-421 (Ga. P.S.C. 1979) (Attrition allowance of .7% approved).

Re: Kankakee Water Co., Case No. 78-0526 (Ill. Commerce Comm'n. Aug. 29, 1979).

Re: Hoosier Water Co., Inc., 34 PUR 3d 348, 353 (Ind. P.S.C. 1960).

Re: Northwestern Bell Telephone Co., 20 PUR 4th 462, 474-476 (Iowa State Commerce Comm'n. 1977).

Re: Cincinnati Bell, Inc., 87 PUR 3d 171, 172 (Ky. P.S.C. 1970) ("In order to provide rates that are sound, when they are made effective and at least for a reasonable period into the future, an allowance for 'attrition' has been made").

Ex Parte South Central Bell Telephone Co., 301 PUR 4th 301 (La. P.S.C. 1974).

New England Telephone and Telegraph Co. vs. Maine Public Utilities Commission, 390 A.2d 8, 27 PUR 4th 1, 44-48 (Me. 1978) (Attrition allowance of .56 percent approved).

Re: Central Maine Power Co., 26 PUR 4th 388, 415-416 (Me. P.U.C. 1978) (The Commission allowed a .16 percent attrition allowance stating: "Since future attrition has been established, it should be compensated for").

Re: New England Telephone and Telegraph Co., 13 PUR 4th 65, 87-88 (Me. P.U.C. 1976) (Attrition allowance of not more than .25% approved).

Re: New England Telephone and Telegraph Co., 20 PUR 4th 388 (Mass. Dept. of Pub. Util. 1977).

Public Service Commission of Maryland vs. Baltimore Gas and Electric Co., 273 Md. 357, 329 A.2d 691 (1974).

Legislative Utility Consumers' Council vs. Granite State Electric Co., 119 N.H. 359, 402 A.2d 644, 646-647 (1979) (Attrition allowance of .5% approved).

Re: Manchester Gas Co., 29 PUR 4th 121, 130-31 (N.H. P.U.C. 1979) (Attrition allowance of .2% approved).

Re: Hudson Water Co., 28 PUR 4th 617, 624-625 (N.H. P.U.C. 1979) (Attrition allowance of .5% approved).

Re: New England Telephone and Telegraph Co., 5 PUR 4th 505 (N.H. P.U.C. 1974).

Re: New Jersey Water Co., Docket No. 735-390 (N.J. Bd. of Pub. Util., Mar. 28, 1974).

Legislature of the County of Rockland vs. New York State Public Service Commission, 49 App. Div. 2d 484, 375 N.Y.S.2d 650, 652 (1975) (Attrition allowance of .5% approved).

City of New York vs. Public Service Commission, 17 App. Div. 2d 581, 237 N.Y.S.2d 617, 621-622 (1963) (Attrition allowance of .25% approved).

Re: Long Island Lighting Co., 24 PUR 4th 131, 151-52 (N.Y. P.S.C. 1978).

Re: New York Telephone Co., 23 PUR 4th 554, 585 (N.Y. P.S.C. 1977).

Re: Chenango and Unadilla Telephone Corp., 16 PUR 4th 477, 487-489 (N.Y. P.S.C. 1976).

Re: Rochester Gas and Electric Corp., 14 PUR 4th 475, 482-483 (N.Y. P.S.C. 1976) (Attrition allowance of .32% approved).

Re: Jamaica Water Supply Co., Case No. 26880, Op. No. 76-20 (N.Y. P.S.C. Sept. 28, 1976).

Re: Narragansett Electric Co., 23 PUR 4th 516, 541-544 (R.I. P.U.C. 1978).

Re: New England Telephone and Telegraph Co., 22 PUR 4th 391, 408-412 (R.I. P.U.C. 1977).

City of Lynchburg vs. Chesapeake and Potomac Telephone Co. of Virginia, 200 Va. 706, 107 S.E.2d 462 (1959).

Re: Chesapeake and Potomac Telephone Co. of West Virginia, Case No. 7496 (W.Va. P.S.C. June 24, 1974).

Re: Wisconsin Telephone Co., 19 PUR 4th 459, 474-475 (Wis. P.S.C. 1977).

Re: Madison Gas and Electric Co., 17 PUR 4th 109, 117 (Wis. P.S.C. 1976).

Opposition

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No. 81-468

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

STATE OF MISSOURI, ex rel.
MISSOURI PUBLIC SERVICE COMPANY,
Petitioner,

v.

CHARLES J. FRAAS, Chairman, Commissioners HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK MCCARTNEY and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,
Respondents.

On Petition For A Writ Of Certiorari To The Missouri Court Of Appeals, Western District

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Has the Petitioner timely presented and preserved its federal constitutional claim where such claim was not raised until after a state court, reviewing a state administrative agency order, issued its final decision?

2. Does the Due Process Clause of the Fourteenth Amendment require that an exception to the federal law of mootness, articulated in *Southern Pacific Terminal Co.* v. *Interstate Commerce Commission*, 219 U.S. 498 (1911), be applied by state courts reviewing state administrative agency orders?

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STATE OF MISSOURI, ex rel.
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v.

CHARLES J. FRAAS, Chairman, Commissioners HUGH A. SPRAGUE, STEPHEN R. JONES, LEAH BROCK MCCARTNEY and ALBERTA C. SLAVIN, as members of and constituting the Public Service Commission of the State of Missouri,

Respondents.

On Petition For A Writ Of Certiorari
To The Missouri Court Of Appeals, Western District

BRIEF IN OPPOSITION

The Respondents reply herein to the petition for writ of certiorari, seeking review of the opinion of the Missouri Court of Appeals, Western District, in this case. That opinion is reported at 615 S.W. 2d 587.

OPINIONS BELOW

Respondents accept this portion of the Petition.

JURISDICTION

The jurisdiction of this Court under 28 U.S.C. 1257(3) has been invoked improperly because Petitioner failed to present its constitutional issues timely in the state court system, and because Petitioner fails to present a substantial federal question here.

STATEMENT OF THE CASE

The proceeding decided by the Missouri Public Service Commission (Missouri Commission), the Respondent in this case, concerned the level of the Petitioner's rates for the sale of electricity and natural gas to Missouri consumers. Whether to include an attrition factor — an adjustment proposed by some companies to alleviate a perceived failure to earn an authorized rate of return — in a company's rates "is essentially a factual question" that is "within the discretion of the Commission . . . ." *State ex rel. Kansas City Power & Light Co.* v. *Public Service Commission of Missouri,* 615 S.W.2d 596, 597 (Mo. App. 1981). The Missouri Commission has never permitted inclusion of an attrition factor, and its decision in the Petitioner's rate case did not allow the inclusion of this factor.

As Petitioner appealed this decision through the Missouri courts, the rates in effect by virtue of the Missouri Commission's order were twice superceded by new rates resulting from subsequent filings made by Petitioner. Petitioner maintained that the Missouri courts should still rule on the attrition factor issue on general public policy grounds. The Missouri Commission took the position that the case was moot, and the Missouri Court of Appeals, Western District, — the last court to issue an opinion in this matter — agreed with the Missouri Commission. Central to the controversy before this Court, the Petitioner never argued in its brief before the Missouri Court of Appeals that there existed an exception to the state court's mootness doctrine of federal constitutional dimension.

Although Petitioner's brief to the Missouri Court of Appeals refers in passing to the Federal Constitution, the federal constitutional argument advanced was that the rate approved by the Missouri Commission, because it

failed to include an attrition factor, resulted in a taking of private property without just compensation — not that the review process in which the parties were engaged failed to afford due process. In short, Petitioner's brief wholly failed to preserve its argument that application of state mootness doctrine here violates a federal constitutional right.[1]

REASONS WHY THE WRIT SHOULD BE DENIED

1. Because the Petitioner Did Not Timely Present Its Constitutional Issue To The Reviewing State Court, Said Issue Has Not Been Properly Preserved For Review By This Court.

On page 20 of its petition, Petitioner states that the "ultimate question" presented to this Court is whether the exception to the mootness doctrine set forth in *Southern Pacific Terminal Co.* v. *Interstate Commerce Commission,* 219 U.S. 498 (1911), which permits federal court review of short-term federal administrative decisions that otherwise might evade review on mootness grounds, is applicable to the states through the Fourteenth Amendment to the United States Constitution. The foregoing issue, phrased in several different ways throughout the petition, was not timely presented to the court below.

Under the law of Missouri, decisions of the Missouri Commission are first reviewed by a Missouri Circuit Court, and that court's decisions in turn are reviewed by a Missouri Court of Appeals. As this case progressed through the state court review process, the Missouri Commission consistently took the position that the controversy was moot. The thrust of Petitioner's defense to

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[1] For the convenience of the Court, Respondents have lodged with the clerk's office ten copies of Petitioner's brief filed before the Missouri Court of Appeals, Western District.

the Missouri Commission's mootness argument before the Court of Appeals is succinctly but completely stated in the title to the first point in its brief before the Court of Appeals:

> The Circuit Court did not err in hearing and ruling upon the issues raised by company's appeal, because company's appeal was not and is not moot in that the company could receive practical relief from a judicial determination of the issues involved, and even if the Court finds these issues to be moot, the issues raised by company present matters of substantial public interest which require judicial determination for future guidance of public officers.

The discussion in Petitioner's brief to the Missouri Court of Appeals under the above point begins on page 21 and continues for fourteen pages, but nowhere therein is a constitutional issue raised or, indeed, is the due process clause of the Fifth or Fourteenth Amendments even cited in passing. Rather, Petitioner sets forth its position that the Western District should decide the case, even if it was technically moot, because judicial guidance is needed and the rate issues on appeal are of substantial public interest. The Western District correctly rejected Petitioners arguments for the reasons of state law set forth in its opinion. (Appendix A to Petition).

Petitioner finally raised the "constitutional" issue in its Motion for Rehearing and Application for Transfer, filed *after* the Western District entered its opinion. The same issue was reasserted in its subsequent Application for Transfer Before the Supreme Court of Missouri.

Missouri law concerning whether new issues can be raised in a motion for rehearing is clear. In *Irwin* v. *Globe Democrat Publishing Co.*, 368 S.W.2d 452, 458 (Mo.

1963) (citations omitted), the Missouri Supreme Court stated:

> It has long been the rule that new propositions and complaints not submitted in the original brief and raised for the first time after the opinion is handed down, or which are clearly afterthoughts, will not be considered on motion for rehearing. We do not propose now to change or relax that rule . . .

See also Weatherford v. *Spiritual Christian Union Church*, 163 S.W.2d 916, 919 (Mo. 1942); *Folger* v. *Lowery*, 210 S.W.2d 1011 (Mo. App. 1948); *Masonic Temple Assoc. of St. Louis* v. *Farrar*, 422 S.W.2d 95, 113 (Mo. App. 1967). More specifically, in *White* v. *State*, 430 S.W.2d 144, 148 (Mo. 1968), the Missouri Supreme Court held that for a constitutional question to be preserved for review, it must be raised at the first opportunity — and cannot be presented in a motion for rehearing. In short, Missouri's procedures afford litigants a reasonable opportunity to have the issue as to the claimed right heard and determined; Petitioner simply failed to use this opportunity. Accordingly, the "constitutional" issue that Petitioner presses before this Court was never preserved under Missouri law and procedure.

It is, of course, true that "when federal rights are involved it is . . . for [the United States Supreme] Court finally to determine whether the failure to follow the procedure designed by a state for their protection constitutes a waiver of them." *Parker* v. *Illinois Brick Co.*, 333 U.S. 571, 574-575 (1947). In regard to new points being raised in motions for rehearings in state courts, however, the United States Supreme Court has held many times that it will not hear cases when the issues contained in said motions have not been seasonably presented. *Hanson* v. *Denckla*, 357 U.S. 235, 243-244 (1958); *Radio Station WOW, Inc.* v. *Johnson*, 326 U.S. 120, 128 (1944); *Amer-*

ican Surety Co. v. *Baldwin,* 287 U.S. 156, 162-164 (1934); *Forbes* v. *State Council of Virginia,* 216 U.S. 396 (1910). When a party could not expect the decision of a court below, there might be reason to consider a constitutional argument raised for the first time on rehearing after the unanticipated decision. *Herndon* v. *Georgia,* 295 U.S. 441, 443-44 (1935). But that exception would not apply here because the Petitioner knew exactly what the Missouri Commission contended and, indeed, responded to that contention. Furthermore, the Western District recently applied the mootness doctrine in the same manner and in similar circumstances to some of the issues raised in *State ex rel. Laclede Gas Co.* v. *Public Service Commission,* 600 S.W.2d 222 (Mo. App. 1980), *appeal dismissed* ____ U.S. ____, 101 S.C. 848 (1981). *See also State ex rel. Missouri Public Service Co.* v. *Pierce,* 604 S.W.2d 623 (Mo. App. 1980).

Because Petitioner's "constitutional" issue has not been timely presented or preserved, the Petition should be denied.

2. The Petition Does Not Present A Substantial Federal Question

While the existence of a federal question in a state court proceeding generally makes the issue of the mootness of the proceeding itself a federal question, *e.g., Liner* v. *Jafco, Inc.,* 375 U.S. 301 (1964), until the state court here ruled that this proceeding was moot, Petitioner had not identified the federal question it presses on this Court.

Petitioner argued below, as it does here (Petition p. 1), that even though the rates approved in this case have been superceded by new rates — and could not be revised retroactively — the Missouri courts should reach

the merits to give guidance to the Missouri Commission as to whether an attrition factor must be included in the future in Petitioner's rates. This was purely a question of the discretion of the Missouri Commission and Missouri courts under Missouri law. Only when the reviewing court declined to reach that issue did Petitioner manage to articulate a federal question — and that question had nothing to do with Petitioner's substantive objection to the Missouri Commission's decision. What Petitioner seeks to do here, then, is to bootstrap a case turning on purely local law into one that turns on resolution of a federal question.

Quite aside from Petitioner's posturing, the question that Petitioner advances as requiring this Court's consideration is not substantial. The cornerstone of Petitioner's theory is the *Southern Pacific* case, which permits federal judges to rule on the legality of a short-term federal administrative agency action that is capable of repetition, yet evading review. Petitioner contends that the United States Constitution requires that the principle of *Southern Pacific* be applied to the decisions of state courts reviewing state administrative actions. Nowhere in that case, however, does this Court explain its conclusion to be required by the Due Process Clause of the Fifth or Fourteenth Amendments to the United States Constitution. Rather, *Southern Pacific* states a rule of decision for federal judges where there is question as to whether a case or controversy in the federal courts requires federal court resolution.

It so happens that the law of Missouri is in accord with the general principle of *Southern Pacific*. The *Laclede* case, *supra*, is an example of a Missouri court deciding issues arising from a decision of the Missouri Commission that was moot. Like federal courts guided by *Southern Pa-*

cific, the Missouri court in that case issued a decision on the merits because of the public importance of the matter and a discerned need for guidance. The guidance that Petitioner demands of the Missouri courts in this case, however, has already been given in *State ex rel. Kansas City Power & Light Co.* v. *Public Service Commission*, 615 S.W.2d 596 (Mo. App. 1981). The state court below was well within its discretion in declining on the ground of mootness to elaborate further on the attrition issue.

For the reasons stated above, no substantial federal question has been presented.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

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